WORKING GROUP REPORT

Corporate Minimum Tax

FAIR TAX • COMMISSION • DE L'ÉQUITÉ FISCALE

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REPORT

March 31, 1992

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Dear Minister:

The Corporate Minimum Tax Working Group of the Ontario Fair Tax Commission is pleased to submit its final report.

Respectfully submitted,

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Corporate Minimum Tax Working Group

REPORT

I. Introduction

The way in which corporations doing business in Ontario are taxed is important for many Ontarians. For corporations, the issue may have a direct impact on the taxes paid by individual companies and on the allocation of the overall tax burden within the corporate sector. For others, the question may have implications for the taxes they themselves pay, for the level of public debt, or for the the capacity of the provincial government to provide the services with which they are familiar.

In June of 1991, the Treasurer of Ontario appointed a diverse group of Ontarians to advise him on the issue of a corporate minimum tax. He asked this Corporate Minimum Tax Working Group to address the following question:

> ***What type of corporate minimum tax (CMT) would be most effective at improving the fairness of the tax system by ensuring that all profitable corporations pay a fair share of the corporate tax burden?***

It was made clear from the outset that the Group was to report directly to the Treasurer and not through the Fair Tax Commission, a body set up in the Spring of 1991 to provide an overall assessment of Ontario's tax system. The views expressed in this Report are, therefore, not necessarily those of the Fair Tax Commission with respect to the need for or design of a corporate minimum tax in Ontario.

It was not intended that the Group work in isolation from the Fair Tax Commission and one of its members sat as an ex officio member of the Group and attended most of its meetings. At the outset, the Fair Tax Commission members augmented the Group's terms of reference to include the following questions:

> ***What are the objectives for a CMT?***
>
> ***Given the objectives, what should the design be? (Can these objectives be met through policy instruments other than a CMT?)***
>
> ***What is the relationship between a CMT and other corporate taxes paid?***

The focus of the Group's work was quite specific: profitable corporations which pay little or no corporate income tax. Some corporations—many more as the current recession deepens—are in desperate financial situations. The Group did not want to make business more difficult for corporations already struggling financially. Instead,

our focus was those profitable corporations paying taxes well below the statutory rate, and in some cases paying no income tax at all.

A threshold question that emerged in the early stages of the Group's work was: do we know what amount of corporate profits now being earned in Ontario bear little or no corporate income tax? The answer to this is that we do not (assuming "now" means 1990-1991) because data for those years are not collected by Ontario or available from other sources. Statistics Canada publishes certain data on the profits of and taxes paid by corporations in Canada but these are subject to a number of important limitations. The numbers are not broken out by province, relate generally to periods about three or four years behind the current year, and are presented in a format that is not particularly helpful in analyzing the basic question concerning the need for a corporate minimum tax.

Nevertheless, as we present in Part II of our Report, new data produced by the Ministry of Revenue provide us with a relatively accurate picture of profits earned and income taxes paid by corporations doing business in Ontario in 1989. As a result, although several members of the Group remained concerned about limitations on our ability to be more specific about the scope of the perceived issue giving rise to the proposal for a corporate minimum tax, most members were satisfied that the Group was able to examine the best available data on the subject.

Further questions concern the reasons why some profitable corporations pay little or no income tax and the distribution of these profits by industry sector and company type. As Part II indicates, it is reasonably clear in a conceptual way why there are differences between reported profits for business (or "book") purposes and the determination of income for tax purposes. While the Group was unable to obtain a precise quantification of the factors giving rise to the payment of little or no tax, some general conclusions are possible. In addition, although the data do not supply a perfect distribution of profits by industry sector or company type, they provide a rough indication of where these profits are earned.

What ought to be the measure of profit for determining whether a corporation not paying corporate income tax is otherwise "profitable"? The discussion of this question usually starts with a comparison of reported profits ("book income") and taxable income. However, it was made apparent to the Group that there is a third way of measuring income/profit that ought to be considered. Economists believe that neither reported profits nor taxable income adequately measure true economic income. They argue that focusing on reported profits as the standard leads either to an over- or under-statement of income, depending on the industry under consideration.

It was beyond the scope of the mandate of the Group to examine the adequacy of the present rules for the calculation of taxable income as part of our consideration of the corporate minimum tax proposal. Nonetheless, we recognized that neither book income nor taxable income necessarily reflect a corporation's ability to pay at any particular time. This is a matter of broader tax policy that ought not to be ignored.

Many members said that if a corporate minimum tax is to be justified on the grounds of fairness, it ought to be targeted at those corporations earning profits in Ontario but unfairly paying little or no corporate income tax. In the course of its overview of the current Ontario corporate income tax system, the Group identified four general reasons why corporations with reported profits may pay little or no income tax: provincial allocation rules, different treatment of equity income and inter-corporate dividends, tax rules regarding loss carryovers, and deliberate tax preferences that allow companies to reduce or defer taxes otherwise payable. These are outlined in Part II of our Report.

Members recognized that these differences reflect diverse features of the corporate income tax system and that it is not legally wrong for a corporation to take deductions allowed by the tax statutes, even if this results in the corporation paying little or no income tax in a particular year. Nonetheless, several members felt that depending on the reason why no tax was paid in a particular year, a case could be made that the corporation was not paying a fair share of tax if the result of claiming otherwise legitimate deductions was the payment of little or no corporate income tax at the same time as it was reporting book profits. In particular, these members felt that a corporation should not be allowed to reduce taxable income below some basic amount by the deduction of tax preferences. From this point of view, a corporate minimum tax could be a fair way of ensuring that all profitable corporations pay at least a minimum amount of income tax. Nevertheless, we were unable to agree whether the amount of profits not taxed as a result of tax preferences is sufficiently large to justify the possible negative effects of proceeding with a corporate minimum tax directed at those profits.

Furthermore, other members of the Group saw no problem in a corporation complying with the provisions of the corporate tax statute and/or favoured the government policies they support, even if the result was the reduction of taxable income to nil. In the case of tax preferences, they emphasized that the enactment of such provisions was an expression of a deliberate policy on the part of the federal or provincial government. They thought the imposition of a minimum tax in such circumstances would undermine the policy intent giving rise to the decision to enact the provision in the first place. In their view, if it is felt that these deductions are no longer desirable in policy terms, the appropriate response would be to repeal or amend them in an appropriate way, not to introduce a corporate minimum tax.

The review of the concepts of economic, book and taxable income and the reasons why some otherwise profitable corporations pay little or no income tax, led to a recognition that some corporations may pay substantial taxes other than income tax, whether or not they earn profits in a particular year. The Group was not specifically asked to consider the overall burden of taxes paid by the corporate sector in Ontario, but felt that in the context of fairness, it would be inappropriate to focus on the corporate income tax to the exclusion of other provincial taxes. In particular, it was noted that Ontario imposes a tax on paid-up capital, which is payable whether or not

a corporation has book profits or taxable income.[1] Corporations with taxable income may deduct capital taxes payable in computing taxable income for income tax purposes. As such, the burden of the capital tax tends to fall more heavily on corporations with no taxable income. In many cases, these are corporations with losses and often reflect start-up or higher risk activities.

Subjecting such corporations to a minimum tax without some regard for the capital taxes payable struck some members as unfair. The Group did not feel qualified to examine in detail the policy ramifications of the overall tax burden on corporations in Ontario in the context of whether a corporate minimum tax ought to be introduced. However, they did feel that the incidence of this overall burden ought to carefully examined as part of any decision to introduce a corporate minimum tax.

Other jurisdictions impose minimum taxes on corporations of one kind or another. Our review in this regard suggests that the more common form of CMT is a tax on capital,[2] although it is by no means clear that Ontario's paid-up capital tax was originally conceived of as a corporate minimum tax. It is reasonably clear that capital taxes are seen as an efficient way of raising revenue from the corporate sector. Conceptually, the major difficulty with a capital tax as a corporate minimum tax is the fact that it is typically not sensitive to profitability. As such, it does not respond to the perceived need to impose a minimum tax on otherwise profitable corporations paying little or no income tax. To a certain extent, profit sensitivity can be addressed in the design of a capital tax, but it remains possible that such an approach may result in some shifting of the tax burden from profitable to marginally profitable corporations. We did not have the resources to explore this concern at any length.

In addition to, or in substitution for, minimum taxes based on capital and income, a few jurisdictions impose a special tax on dividend distributions as part of a tax structure designed to integrate in whole or in part the combined taxes paid by corporations and their shareholders. Ontario follows the federal model and, with the exception of certain income earned by private corporations, partially integrates corporate and shareholder income through the dividend tax credit and the provisions for a tax free flow of inter-corporate dividends. This latter provision is an important feature of the Ontario system for taxing corporations and raised a concern on the part of those members who feel a CMT is required in Ontario.

As the system now works, dividends passing from one corporation to another are not generally taxable in the hands of the recipient corporation. In theory, this is based on the premise that the profits out of which the dividends are paid have already borne corporate income tax. The exclusion from tax in the hands of the

[1] This capital tax applies to all companies with assets of $1 million or more and gross revenues of $1 million or more.

[2] See Antonio Estache, "Minimum Taxes on Business Activities: A Brief Introduction to Design Issues". In Canada, general capital taxes are levied in Manitoba, Ontario, Quebec and Saskatchewan, as well as

recipient ensures that those dividends are not taxed again until the dividends leave the corporate sector and are received by individuals. The present system does not, with one important exception, deal with the case where little or no tax is paid on the underlying profits out of which the dividend is paid.[3] Some members felt that it was not appropriate to allow dividends to pass tax free between corporations if the underlying profits had not been taxed. They noted that inter-corporate dividends comprise a substantial portion of the profits of some corporations reporting book profits and paying little income tax and thought some sort of minimum tax ought to be levied on dividends (whether on a paid or received basis) where little or no tax was paid on the profits out of which the dividends were paid. Such a tax would not be a CMT as such, but would address what some members saw as an anomaly in the structure of the present system.

Most members did not feel that the Group had the opportunity to adequately consider how this perceived anomaly ought to be addressed, if at all. Of particular concern was the fact that Ontario follows the federal approach to the taxation of dividends, as do all the other provinces. We thought a good deal of study was required before it could be said that Ontario ought to introduce a separate system for taxing dividends. It seemed to several of us that this matter should be considered by the Fair Tax Commission as part of its overall review of the tax system in Ontario.

Late in the summer of 1991, we contacted over 100 groups, associations, corporations and other interested bodies, advising them of the Group's mandate and inviting submissions on the question whether some sort of minimum tax was needed in Ontario. We asked them to comment specifically on whether any such tax should be based on income or capital. We received 34 written responses as well as a number of oral comments.

The request for submissions was seen as important by some members of the Group in view of the stated desire of the government to encourage the widest possible input in the tax policy formulation process. Other members of the Group noted that the composition of the Group itself ensured a relatively broad cross-section of opinion would be taken into account. They thought it was unrealistic for the Group to attempt to engage in a dialogue with third parties in view of the limited time within which the Report was to be delivered. In addition, it was pointed out that non-profit and low income sectors would be unlikely to participate in the consultative process for lack of resources. In particular, to the extent that much discussion of corporate taxation inevitably involves technical details, several members indicated that these groups require access to technical resources to fully participate in the debate.

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at the federal level in the form of the Large Corporations Tax on companies with assets of $10 million or more. All provinces levy capital taxes on financial institutions.

[3] The exception is the special treatment of dividends paid on certain types of preferred shares.

Experience proved this latter concern to be well-founded. The non-profit or low income groups we contacted were generally unable to respond to our request for a written brief. As a result, although several members viewed the outcome as predictable given the direct interest in the issue among the business community, virtually all of the written submissions received reflect the views of the corporate sector. Almost all of those responding saw a corporate minimum tax as being unnecessary at best and likely to be damaging to Ontario if adopted, at worst. To this extent we were unable to generate a broadly based discussion of the corporate minimum tax issue among the various constituencies interested in the subject. If the consultative process is to be effective, many members felt that some way needs to be found to assist those interested parties with limited resources in making their views known in an appropriate way.

The question whether Ontario should adopt some form of CMT raises policy issues that go beyond the structure of the corporate income tax. To the extent that the raising of taxes involves judgments about social as well as economic issues, it is difficult to consider changes to the existing system in isolation of the broader context within which tax policy questions arise. Some members were concerned that the Group did not have the time or the resources to explore the relevance of a decision on a corporate minimum tax in this broader context. This raises a basic question about the role of the Group in the tax policy formulation process. Although we did not discuss this question at length, it may be that the Group's function should be seen as the raising of a range of social, economic and structural issues for further analysis by those with the resources and time to do so on a proper basis.

The Group was divided on whether or not Ontario should introduce a corporate minimum tax. We did agree on what we saw as the arguments for and against the proposition, and these are set out in the first section of Part III. At this point, some members felt that the Group had done all that it could having regard for the question posed by the Treasurer. Others felt that in light of the Treasurer's question, the Group should proceed to examine how a corporate minimum tax might be implemented in Ontario and the pros and cons of the approaches to a CMT taken in other jurisdictions. Generally, most members agreed to this, with the following qualifications.

Those members who did not agree that a corporate minimum tax was needed made it clear that their willingness to proceed with a review of possible design options in no way implied an acceptance of the desirability of a CMT. Also, some members were very concerned that the Group did not have available to it either the data or analytical resources to make informed decisions with respect to possible design options. They saw the exercise of engaging in a discussion of options on a theoretical level without an analysis of the economic impact of a particular option as likely to lead to misleading and perhaps dangerous conclusions as to the appropriate course to be followed in Ontario. They urged that any preliminary views emerging from such a theoretical discussion be subjected to rigourous analysis before a decision is made to proceed with any particular form of corporate minimum tax, if at all.

Related concerns on the part of many members involved the degree to which an Ontario CMT would contradict harmonization of the corporate tax system among federal and provincial governments and whether the Group was in a position to assess the likely impact of a corporate minimum tax in Ontario on the competitive position of the province within Canada and in the international marketplace. Several members felt strongly that any tentative conclusion on the design of a corporate minimum tax for Ontario should be considered in the context of its likely impact on competitiveness. Most members were particularly concerned about how a corporate minimum tax would be perceived by businesses now doing business in the province, as well as those looking at Ontario as one of several possible locations for new investment. We recognized that perceptions were not always accurate but were in themselves part of the reality within which policy choices had to be made. If a decision is made to proceed with a CMT, we thought that consideration needed to be given to how such a tax might be announced in order to minimize the negative aspects of a perceptual kind.

Although this Report sets out a range of options for consideration, it does not provide a definitive answer to the basic question of what sort of corporate minimum tax would result in a fairer sharing of the corporate tax burden in Ontario. In a sense, this is a consequence of the nature of the Group itself, and the limitations under which it operated. We do not see the failure to reach consensus on the basic question as a failure of the process. The informed discussion of tax policy often exposes fundamental differences of opinion about the course of action to be followed. In the end, the choice of direction is dictated by political considerations, as it should be. We hope this Report will assist those engaged in the process to better understand the range of issues involved in asking the question what form of corporate minimum tax would lead to a fairer sharing of the corporate tax burden in Ontario.

II. Background to a Corporate Minimum Tax

Popular interest in a corporate minimum tax originates in two aspects of the corporate tax system that have received considerable attention in recent years.

First, media reports have raised questions about the fairness of a tax system in which companies reporting sometimes substantial annual profits may pay little or no income tax. Second, evidence of a decreasing share of total tax revenues raised from the corporate sector has contributed to concerns about a potential reduction in the progressivity of the overall tax system.

Before considering whether or not Ontario should introduce a corporate minimum tax, or how it should be designed if introduced, the working group explored both these issues as well as the implications of introducing a corporate minimum tax in the context of the current economic climate in Ontario and the competitive pressures facing Ontario businesses.

(A) Corporate Profits and Corporate Taxes

All members of the working group agreed that governments require tax revenues to finance important programs and that corporations have a responsibility to contribute resources to help fund these programs. Members were also agreed that this fiscal need is particularly acute in the Province of Ontario at this time, given the severity of the current recession.

Nevertheless, there was less agreement on the role that corporate income taxes (as opposed to other taxes paid by corporations) should serve in performing this revenue-raising function, and on the question of whether or not it is fair for a company reporting annual profits to pay little or no income tax.

In particular, members agreed that in order to evaluate the merits and design of a corporate minimum tax the working group should consider the reasons why profitable corporations may pay little or no income tax, the magnitude of this phenomenon in Ontario, and the significance of other taxes paid by corporations.

Analytical Overview

The reasons why profitable corporations may pay little or no income tax cannot be explained without some understanding of the purpose and structure of Ontario's corporate income tax system and the manner in which corporate tax provisions account for this phenomenon.

Although all taxes are ultimately levied in order to raise revenues, public finance theorists generally agree that the corporate income tax performs two specific func-

tions: a "withholding function" on the income of the company's shareholders,[4] to guarantee that foreign shareholders pay domestic tax on corporate income and to ensure that domestic shareholders cannot defer taxes on income retained by corporations; and an economic and social policy function through which deliberate tax incentives are intended to encourage corporations to alter their behaviour in order to advance economic or social policy goals. While the first function is broadly consistent with the goal of raising revenues, the second describes a number of deductions or credits that companies may utilize in order to reduce taxes payable and reflects the delivery of government expenditure programs through the tax system.

In light of these two functions, it is possible to summarize some of the key characteristics of the corporate income tax system in Ontario, and to identify the main reasons why corporations which report annual profits may pay little or no Ontario income tax. While working group members did not agree on every aspect of this existing tax system, it was generally agreed that some of these reasons were more acceptable than others, and that the case for a corporate minimum tax was strongest when targeted at deliberate tax preferences serving the economic and social policy function of the corporate income tax, rather than other features of the corporate income tax system that account for differences between annual book profits and taxable income.

Ontario Income

At the outset, it is important to recognize that Ontario is only one jurisdiction in a federal country, and that corporations often operate in several provinces and in countries other than Canada. Although Ontario's corporate income tax is based largely on the federal definition of taxable income for Canadian tax purposes, companies are required to pay Ontario income tax only on profits that are allocated to Ontario according to a formula that is generally based on the provincial share of the company's Canadian sales and payroll.[5] For companies that also conduct business outside Canada, Canadian tax provisions regulate inter-company transactions in order to limit opportunities to transfer taxable income to low tax jurisdictions, and provide tax credits to ensure that firms operating in Canada do not pay additional tax on profits already taxed in another country.

For accounting purposes, corporations do not report profits based only on Ontario source income. As a result, provincial allocation rules and foreign tax credits are two

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[4] Since corporations (unlike natural persons) have no independent ability to pay, distinct from that of their shareholders, employees, customers or suppliers, the corporate income tax cannot (unlike the personal income tax) be justified as an independent levy on changes in the company's economic well-being from one period to the next. Instead, public finance theorists view the corporate income tax as an administratively convenient method of taxing income that is earned within a corporation but which ultimately accrues to the company's shareholders. This is not to suggest that businesses should not pay additional taxes in recognition of the benefits that they receive from government expenditures (e.g., on education or transportation).

[5] Different allocation rules apply to banks, insurance companies, transportation companies, shipping companies, and pipelines.

reasons why companies that report annual profits may nevertheless pay little or no Ontario income tax: although reported by companies filing Ontario tax returns, these profits may have been allocated to other provinces or earned outside Canada.

Inter-Corporate Dividends and Equity Income

A second feature of the corporate income tax system that enables some profitable corporations to pay little or no corporate income tax involves the appropriate definition of corporate income for purposes of a withholding tax on shareholders.[6] While accounting income includes dividends received from other companies and equity income earned by subsidiaries, tax rules generally exclude these items from taxable income on the assumption that they have already been taxed at the level of the distributing corporation or subsidiary.[7] Although this assumption may be mistaken in any single case,[8] these provisions reflect the withholding function of the corporate income tax by preventing multiple taxation of corporate income.[9]

Business Losses

A third feature of the corporate income tax system concerns the period of time over which income is to be measured. For accounting purposes, profits are reported on an annual basis; under Canadian income tax rules, however, corporations may use current years' business losses to offset income in any of the previous three years, and may carry these losses forward to offset income in any of the subsequent seven years.[10] They may also refrain from using certain deductions (e.g. capital cost allowances) and carry these forward indefinitely.

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[6] For many public finance theorists, this definition entails a concept of economic income accruing to shareholders: revenue from the sale of goods and services plus financial income, less current costs, economic depreciation, and the cost of borrowed funds. While this economic definition operates as a valuable guidepost to the actual definition of the corporate income for tax purposes, it is traditionally rejected as an operative definition on the administrative grounds that it would entail full inflation indexing and annual taxation of any appreciation in the market value of assets owned by a corporation.

[7] Inter-corporate dividends are subject to a refundable tax of 25 percent in the case of personal investment companies and to a special tax on preferred share dividends. On the same assumption that dividends have already been taxed at the corporate level, individual recipients of dividends are entitled to a dividend tax credit equal to 25 percent of the dividend actually received.

[8] Because of corporate tax incentives, it is possible that a subsidiary or distributing company could pay little or no tax on the equity or dividend income that is reported in the books of the parent or shareholder company. Where this occurs, these provisions can create a tax advantage to conducting economic activity through a corporation.

[9] Because the dividend tax credit is set at 25 percent, perfect "integration" of the corporate and personal income tax systems works only for an actual (combined federal and provincial) corporate tax rate of about 20 percent, a rate roughly corresponding to the statutory rate on Canadian Controlled Private Corporations. Where actual rates exceed this percentage, as do the (combined federal and provincial) statutory rates for public companies, "under-integration" occurs and the tax system creates a disincentive to conducting economic activity through a corporation; alternatively, where actual rates drop beneath this level, the tax system creates a positive incentive to conducting economic activity through a corporation.

[10] In the case of capital losses, companies can carry losses back for three years and forward indefinitely.

These "carryover" periods are invariably somewhat arbitrary. They were shorter in Canada only a decade ago. They are longer today in the United States; on the other hand, the United States does not permit the carryforward of unused deductions. Nevertheless, these rules reflect an underlying view that the period of measurement for the purpose of corporate income taxation should be more than a single year: that it would be unfair to tax firms with fluctuating incomes on a strictly annual basis, and that it would be inefficient to discourage risky investments by taxing profits without also providing some relief for losses.[11] They also constitute a further reason why companies with annual profits may nevertheless pay little or no income tax.

Tax Preferences

A final way in which profitable companies may pay little or no income tax reflects the second function of the corporate income tax as an instrument of economic and social policy. Contrary to the goal of raising revenue and to the withholding function of the corporate income tax, governments often enact deliberate provisions intended to encourage specific behaviour by allowing companies to reduce their income taxes below amounts that would otherwise have been payable. These incentives or tax preferences typically take one of three forms: exemptions, deductions and credits which result in a permanent reduction of income taxes below amounts otherwise payable; accelerated write offs which enable firms to defer taxes from whenever they were otherwise payable; and rate reductions which allow specific kinds of companies to pay taxes at rates lower than otherwise applicable.

Although federal tax reform in 1987 reduced many of the tax preferences previously available to companies operating in Ontario, several such items remain, including some that were introduced by the provincial government after 1987. While federal tax reform increased the capital gains inclusion rate from 50 to 75 percent, a quarter of capital gains remain non-taxable.[12] Investment tax credits were significantly curtailed, but are still available for research and development, though subject to a percentage limitation in the case of large corporations.[13] Special resource deductions for "earned depletion" were eliminated,[14] but since 1974 a federal resource al-

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[11] In fact, some economists argue that in order to remove any tax disincentive to risky endeavours, losses should be fully refunded in the year they are incurred at a rate equivalent to the corporate tax rate. Otherwise, relief for losses is incomplete since they cannot be carried forward at market interest rates and they may not be exhausted within the specified carryover period

[12] This exemption is often explained as a form of rough compensation for the effect of inflation in exaggerating the amount of the gain. On the other hand, the amount of the exemption does not vary with the length of time during which the asset is held. In the case of capital gains on shares held by public companies, however, an argument can be made that the gains should be completely exempt for the same reason that inter-corporate dividends are generally non-taxable: on the assumption that the company issuing the shares pays tax on the earnings that are reflected in its increased share prices, capital gains taxation on the sale of these shares would involve double taxation of the underlying income.

[13] Investment tax credits are also available for investment in slow growth regions of the country. Investment tax credits may be used to reduce federal but not provincial income taxes.

[14] These applied only at the federal level, and did not reduce Ontario taxable income.

lowance has exempted a quarter of all resource profits earned in Canada.[15] Furthermore, despite phasing out a small business tax holiday beginning in 1988, Ontario retains special deductions for companies conducting scientific research and development in Ontario (the Research and Development "Superallowance") and for companies purchasing pollution control equipment for use in Ontario (the Ontario Current Cost Adjustment). Each of these preferences permanently reduces corporate income taxes below amounts otherwise payable and may allow some otherwise profitable companies to pay little or no income tax.

Accelerated write-offs also remain despite reductions under federal tax reform. While tax reform reduced the rate at which companies can write off the cost of capital assets, a number of asset categories receive "capital cost allowances" (CCA) that are more generous than the rates of depreciation allowed for accounting purposes.[16] Further, companies are still allowed to deduct the full costs of resource exploration and equipment used substantially for scientific research and development in the year they are incurred,[17] and to allow accelerated write-offs for resource development costs. Each of these preferences enables companies to defer corporate income taxes beyond when they would otherwise have been payable, allowing some otherwise profitable companies to reduce or eliminate income tax in a given year.

Finally, both federal and provincial tax rules permit specific kinds of companies to pay taxes at rates lower than generally applicable. In contrast to a general federal rate of 28 percent and a basic Ontario rate of 15.5 percent, companies engaged in manufacturing and processing are taxed at preferential rates of 23 percent federally and 14.5 percent in Ontario,[18] and small businesses are taxed at a federal rate of 12 percent and an Ontario rate of 10 percent.[19] Although these rate reductions do not allow profitable companies to pay no income tax, in conjunction with other tax provisions they may enable some profitable corporations to pay little income tax.

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[15] This provision is designed to offset federal disallowance of royalties and mining taxes as deductions in calculating taxable income. Where the allowance exceeds these resource payments, the company obtains a permanent reduction in income taxes. Where resource payments exceed the resource allowance, a permanent tax increase occurs.

[16] In addition to this incentive element, accelerated capital cost allowances are often viewed as a means of offsetting the impact of inflation on income accounting where capital costs are calculated on the basis of the original cost of the productive asset while revenues are valued in current terms.

[17] For accounting purposes, these costs are generally treated as capital investments and deducted over the period of time during which they are used to generate income.

[18] This rate also applies to agriculture, forestry and fishing. The recent federal budget proposes to reduce the federal manufacturing and processing rate to 22 percent in 1993 and 21 percent in 1994.

[19] Federal rates are expressed as statutory percentages less a 10 percent provincial abatement. The small business rate applies to the first $200,000 of active business income earned by a Canadian-controlled private corporation or associated group of such companies. Ontario restricts the benefit of its small business rate by clawing back the provincial rate reduction on corporate income over $200,000.

Empirical Overview

Having considered in a conceptual way the reasons why corporations reporting annual profits may pay little or no income tax, the working group attempted to assess the magnitude of this phenomenon in Ontario, particularly the extent to which it is attributable to tax preferences.

The first figures examined by the Group indicated that of about 363,000 corporations in Canada reporting annual profits in 1987, roughly 118,000 with total book profits of $25 billion paid no federal or provincial corporate income tax, while another 28,000 earning almost $18 billion paid income taxes at average rates amounting to less than 10 percent of their book profits.[20]

While this data supports other reports suggesting the existence of a significant national problem of non-taxpaying corporations at that time,[21] members raised three objections to the use of these figures to support the introduction of an Ontario-based corporate minimum tax in 1992: first, since these figures are Canada-wide, they merely suggest patterns that may or may not exist in Ontario; second, as aggregate figures on book profits and corporate income taxes, this data does not indicate the reasons why some corporations pay little or no income tax, particularly the extent to which this phenomenon is attributable to tax preferences as opposed to other features of the corporate income tax system that account for differences between annual book profits and taxable income; finally, since they are based on 1987 data, these figures fail to reflect the impact of federal tax reform measures which were partly intended to increase the number of taxpaying companies.[22]

Despite recognizing the limitations of this initial data, the working group experienced considerable difficulties obtaining recent and reliable evidence on the number of profitable corporations paying little or no Ontario income tax and on the reasons

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[20] Canada. Statistics Canada, Corporate Income Tax, 1987 Special Tabulation.

[21] See, e.g., David Holland and Alain Castonguay, "The Corporate Income Tax: Preliminary Results on the Impact of Tax Reform," pp. 4-9.

[22] Federal simulations at the time of tax reform indicated that of 110,000 profitable corporations that paid no corporate income tax in 1983, 50,000 would have paid tax had the fully phased-in tax reform measures applied in that year, and that of the remaining 60,000 profitable non-taxpaying corporations, 35,000 would have become non-taxable because of prior-year losses while about 25,000 would have remained non-taxable on account of remaining incentives [Canada: Department of Finance, *White Paper on Tax Reform*, pp. 66, 68]. More recent federal simulations based on a sample of 1987 corporate tax returns conclude that of 115,500 profitable corporations that paid no corporate income tax in that year, 53,000 would have paid tax had the fully phased-in tax reform measures (including the federal Large Corporations Tax introduced in 1989) applied in that year; of the remaining 62,500 profitable non-taxpaying corporations, 23,690 would have been non-taxable because of prior-year losses, 30,265 reported profits of less than $25,000, and 2,500 were small corporations using tax credits of no more than $24,000 to offset corporate tax otherwise payable. As a result, the authors conclude, only 6,045 profitable corporations would pay no tax after tax reform [Holland and Castonguay, pp. 36-38]. Unfortunately, these statistics contain no figures on the number of profitable corporations simulated to pay little tax after tax reform, nor on the amount of corporate profits upon which little or no tax would have been paid; nor do they contain any breakdown indicating the proportion of these corporations located in Ontario.

why this is so. Some of these have to do with the federal nature of corporate income taxation in Canada and from federal supervision over the collection and analysis of most data on the corporate tax system.[23] Others are attributable to tax rules on the carryback of losses, which make the results of any single tax year conditional until three years have passed.[24] Finally others stem from phase-in periods for tax reform measures enacted in 1987 and from carryforward provisions which make it difficult to assess the ultimate impact of tax reform on the basis of any current data.[25]

Nevertheless, through the consistent efforts of officials at the Ontario Ministry of Revenue, the working group was able to obtain detailed data on corporations and taxes paid for most corporations which filed Ontario tax returns in 1989.[26] Although subject to some qualifications on account of the preliminary character of the data,[27] this approach provides rough estimates on numbers of corporations and amounts of corporate profits which paid little or no Ontario income tax in taxation years ending during 1989, and on the main reasons why this occurred.

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[23] Since this information is confidential, a special amendment was required to federal Income Tax Regulations before information could be released to the working group for purposes of "the evaluation or formulation of the province's tax policy." This amendment was passed by an Order in Council on September 19, 1991.

[24] As a result, it was only in the fall of 1991 that the Department of Finance made information available on the results of the 1988 tax year. See Holland and Castonguay, pp. 28-34.

[25] Since changes to some capital cost allowances were phased in between 1988 and 1991, it is only at the end of this period that one can begin to examine a fully mature system. Nevertheless, because companies with losses that were built up under the pre-reform system can carry these forward for up to seven years, it will be several years before this so-called "overhang" will disappear. Even then, since a number of unused deductions (e.g., unused capital cost allowances) can be carried forward indefinitely, there is theoretically no limit on the influence of the pre-reform system on "post-reform" data. Because of these limitations, the Department of Finance has twice attempted to measure the impact of tax reform by simulating what would have happened if a fully mature tax system had been in place in 1983 or in 1987. Officials at the Ontario Ministry of Treasury and Economics have obtained a database in order to conduct similar simulations, but have yet to produce such estimates for Ontario.

[26] This was accomplished by matching federal data from the Provincial Tax Administration Database (PTAD) with information collected from Ontario tax returns and assessments. Of 190,231 returns filed in 1989, officials at the Ministry of Revenue were able to match 176,790 (93%) with information contained in the federal database.

[27] Aside from general limitations associated with 1989 data (which fails to incorporate loss carrybacks and reflects only partly phased-in tax reform measures), the PTAD tape (which had yet to be checked for errors by Revenue Canada) was found to contain a number of incorrect data entries, and displayed considerable ambiguity in its treatment of inter-corporate dividends which were excluded from the PTAD figure on approximately 50 percent of actual files reviewed and included in the remainder. Although officials at the Ministry of Revenue have corrected many data entries, and have proceeded on the assumption that inter-corporate dividends are included in all financial statement profits (thereby adopting a lower bound estimate on the amount of corporate profits subject to little or no corporate income tax), the quality of the underlying data remains imperfect. In addition, since PTAD profit entries include the equity income of subsidiaries, the PTAD figures reflect a double counting of some corporate income; preliminary analysis suggests that at least $1 billion of untaxed corporate income represents equity income.

The first pair of diagrams shows the number of profitable corporations (and associated profits) which paid little or no Ontario income tax in 1989, taking "little" to denote an average tax rate no more than 5 percent of each corporation's financial statement profits multiplied by the percentage of its taxable income allocated to Ontario. Of almost 177,000 corporations for which data was available, roughly 30,000 companies with total reported profits of almost $24 billion paid little or no Ontario income tax.

The second pair of diagrams identify and quantify some of the reasons why some of these profitable corporations (and corporate profits) paid no income tax, showing the impact of equity income, inter-corporate dividends, prior years' losses, and the small business tax holiday that was cancelled after 1989. Adjusting for these factors, roughly 6700 profitable companies and $6 billion of profits remained non-taxable.[28]

Although the Ministry's database did not permit more detailed analysis of the reasons why these companies and profits were not subject to Ontario income tax, a sample of 144 large non-taxpaying firms provides some indication of the remaining reasons why profitable corporations may pay little or no income tax.[29] As the fifth diagram indicates, among these 144 companies five items accounted for almost 90 percent of deductions from accounting income (after subtracting equity income and inter-corporate dividends, and allowing for prior years' losses): differences between statutory capital cost allowances and book depreciation were the most important of these items, followed by non-taxation of rollovers and accounting gains on corporate assets,[30] resource deductions, the 25 percent exclusion rate on capital gains, and the Ontario Research and Development Superallowance.

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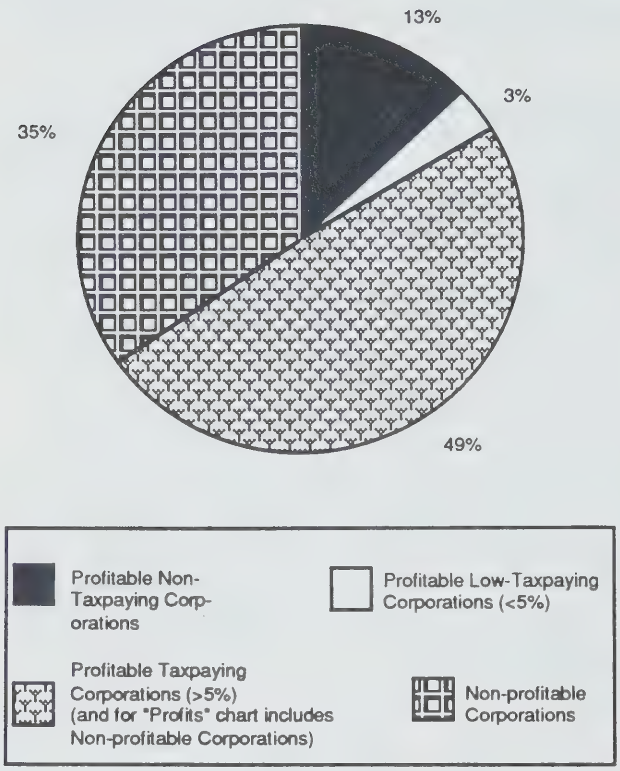
[28] About 55 percent of these profits, or $3.3 billion, were allocated to Ontario for income tax purposes.

[29] Together, these companies accounted for more than half of the $18.5 billion profits earned by profitable companies that paid no Ontario income tax in 1989.

[30] Gains recognized for accounting purposes but not for tax purposes on tax-free reorganizations in which assets are transferred among members of the same corporate group without loss or gain to the group as a whole.

Diagrams 1 and 2: Profitable Corporations (And Associated Profits) Which Paid Little Or No Ontario Income Tax In 1989

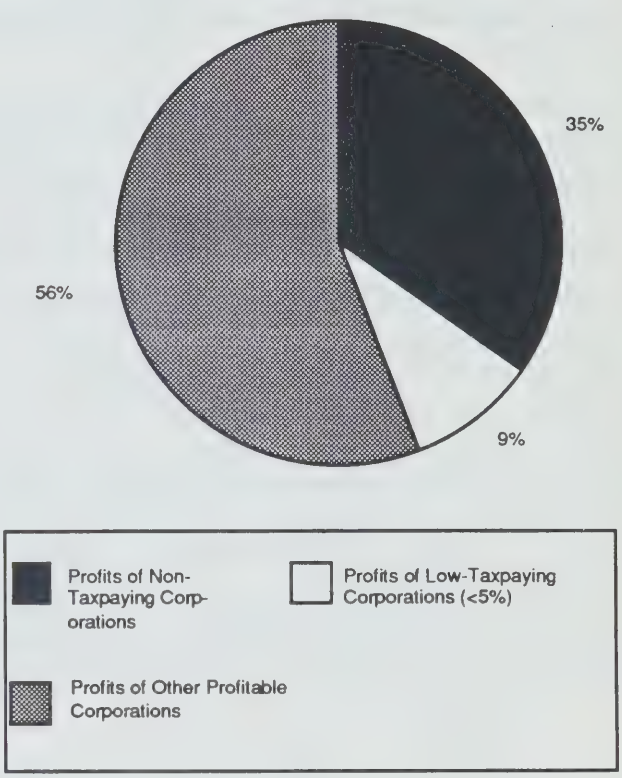
All Corporations



Of almost 177,000 corporations for which files were matched, roughly 116,000 reported book profits in 1989, of which 23,300 paid no Ontario income tax.

A further 6000 corporations (estimated) paid Ontario income tax in 1989 at an average rate of less than 5% of Ontario book profits.*

Profits of Profitable Corporations



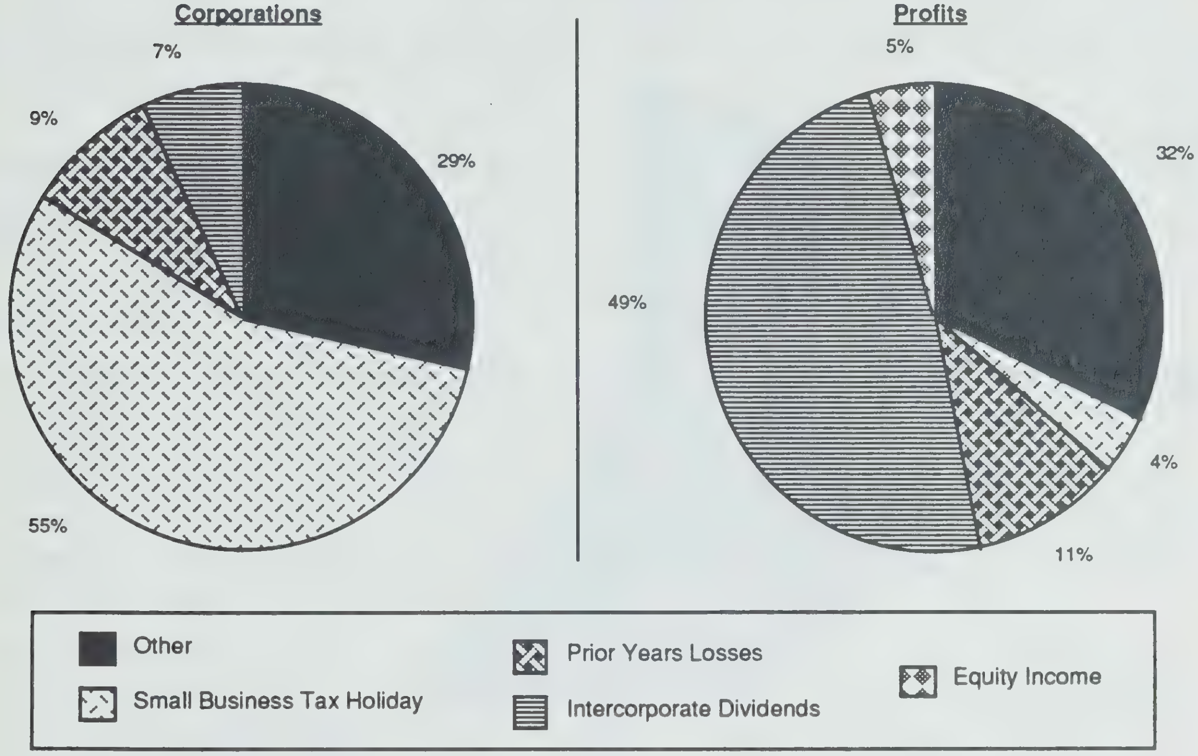
Of roughly $53 billion earned by profitable corporations for which files were matched, about $18.5 billion was earned by companies that paid no Ontario income tax in 1989.**

A further $5 billion (estimated) was earned by corporations that paid Ontario income tax in 1989 at an average rate of less than 5% of Ontario book profits.

* "Ontario book profits" = financial statement profits multiplied by the percentage of each corporation's taxable income that is allocated to Ontario for income tax purposes.

**These dollar amounts refer to Canadian and in some cases worldwide income, not to Ontario-allocated income that is subject to Ontario tax. Although the average Ontario allocation for all profitable corporations is about 60 percent, this ratio varies from firm to firm and is generally lower (roughly 55 percent) for profitable non-taxpaying companies.

Diagrams 3 and 4: Reasons Why Profitable Non-Taxpaying Corporations Paid No Ontario Income Tax in 1989

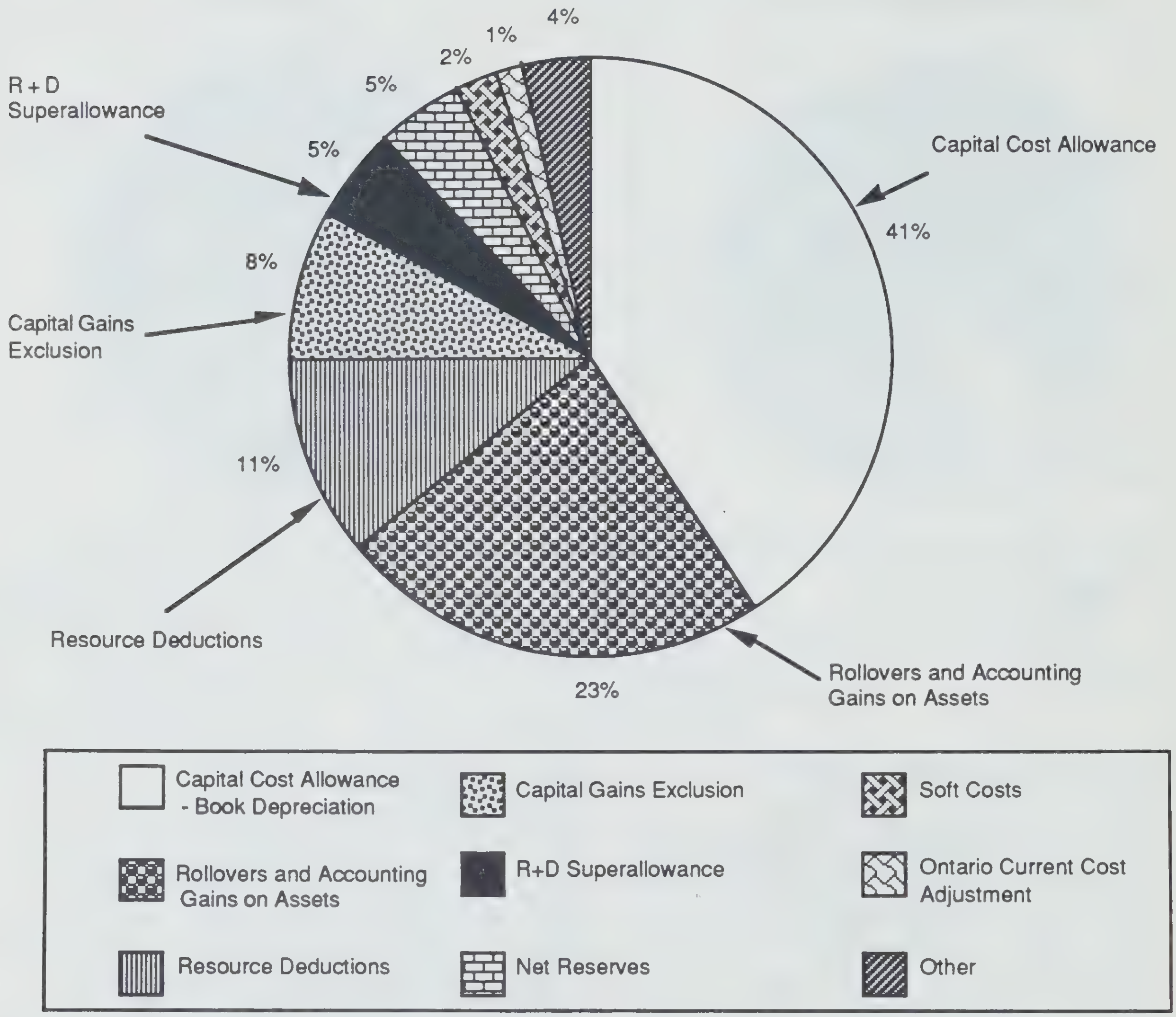


Of the 23,300 profitable corporations that paid no Ontario income tax, roughly 12,800 were non-taxable on account of a subsequently abolished tax holiday that Ontario offered to new small businesses in 1989, 1600 paid no corporate income tax in Ontario because intercorporate dividends are not taxed, 2200 used prior years' losses to offset corporate income tax otherwise payable, and a further 6700 corporations were non-taxable for other reasons.

Of the $18.5 billion of profits earned by the 23,300 profitable non-taxpaying corporations, roughly $700 million was non-taxable because of the small business tax holiday, $2 billion was non-taxable because of prior years' losses, $9 billion was non-taxable because intercorporate dividends are not taxed, at least $850 million represents equity income which is taxable at the subsidiary level,* and almost $6 billion was untaxed for other reasons. Roughly 55 percent of these profits, or $3.3 billion, were allocated to Ontario for tax purposes.

* Although the PTAD tape does not allow for a precise specification of equity income, further analysis by officials at the Ministry of Revenue indicates that of about $6 billion earned by 121 large companies which were non-taxpaying in 1989 for reasons other than receipt of inter-corporate dividends, application of prior years ' losses and/or the small business tax holiday, roughly $850 million represents equity income on investments.

Diagram 5:
Other Reasons Why Profitable Corporations Paid No Ontario Income Tax In 1989
Profits



Based on a sample of 144 companies which paid no Ontario income tax in 1989, the above deduction items constitute the major reasons (after adjusting for equity income, inter-corporate dividends, prior years' losses, and the small business tax holiday) that explain why profitable corporations may pay little or no income tax.

Rollovers and Accounting Gains - "Paper gains" on corporate rollovers - Gains that are recognized for accounting purposes but are not recognized for tax purposes on tax-free intercorporate reorganizations in which assets are transferred between members of the same corporate group without any economic gain or loss to the group.
Net Reserves - Amounts deducted from income to reflect various contingencies. Examples of deductible reserves include reserves for doubtful debts, reserves for amounts not due until a later year, reserves for undelivered goods or unrendered services.
Soft Costs - Prior to tax reform, "soft costs" (e.g. interest, accounting and legal fees, insurance and property taxes) attributable to a period of construction or renovation of a building could be fully deducted in the year the costs were incurred. Tax reform imposed restrictions on the deductability of "soft costs".
Other - This category includes pension adjustments, deferred charges, asset write-offs, plant closure and restructuring costs, price support, deferred tax adjustments and miscellaneous other items.

Finally, further analysis of the corporations and untaxed profits that remain after adjusting for equity income, inter-corporate dividends, prior years' losses, and the small business tax holiday, provides useful information on the industry sectors and corporate profiles of companies that pay no income tax as a result of other deductions, and on the significance of Ontario's paid-up capital tax for these profitable non-income-taxpaying firms.

Diagrams six to eight depict taxed and untaxed profits by industry sector, corporate structure and company size. In both absolute and relative terms, these figures suggest that the remaining ways in which profitable corporations may pay little or no income tax are mainly employed by manufacturing and insurance companies, and by large corporations.

Diagrams nine to eleven depict capital taxes paid by non-income-taxpaying firms as a proportion of total capital and income taxes paid according to industry sector, corporate structure and company size. Although this data indicates a rough correlation between the size of the capital tax burden and the areas where profitable companies are most likely to pay no income tax, it is also clear that most capital taxes are paid by profitable corporations that already pay at least some income tax or by companies reporting financial losses.[31]

The working group did not reach any clear conclusions on what this data says about whether or not Ontario should introduce a corporate minimum tax, nor about the design of such a tax if introduced. For some members, the fact that $6 billion of corporate profits were not subject to income tax in 1989 (even after adjusting for equity income, inter-corporate dividends, prior years' losses, and the small business tax holiday) confirms the need for a corporate minimum tax and suggests that the revenue raised by such a tax might not be insignificant.[32] For others, however, the small share of all untaxed profits that are traceable to explicit preference items, and uncertainty about the revenue that would be raised by any actual corporate minimum tax suggest both that the need for a corporate minimum tax in Ontario is not apparent, and that the revenues raised by such a tax may not justify the effort.[33]

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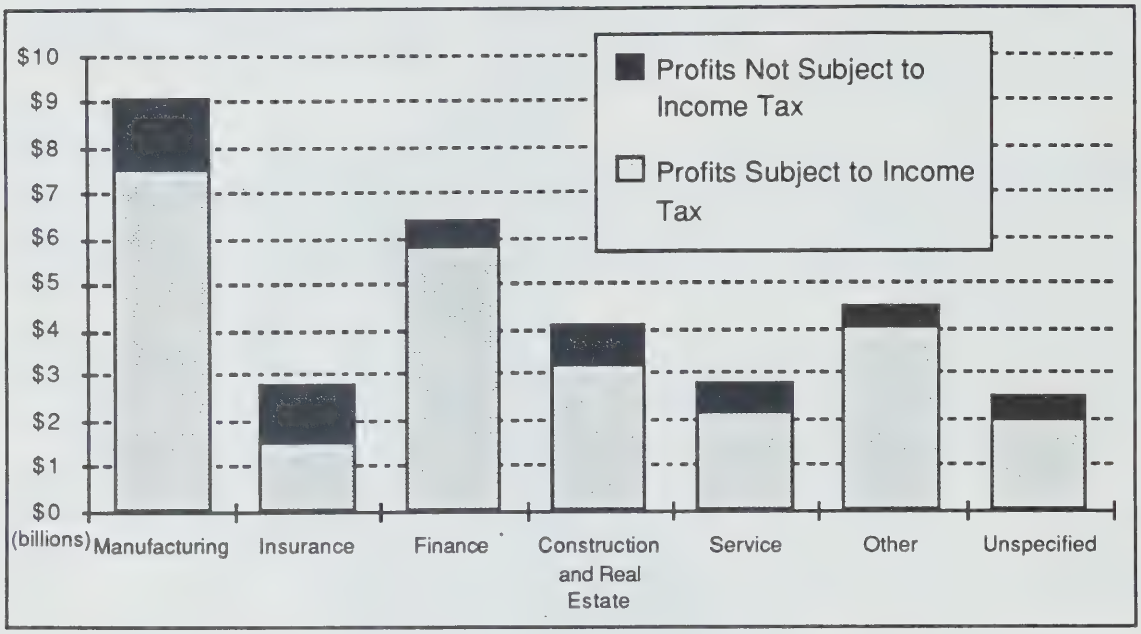
[31] Of $857 million in Ontario capital taxes paid in 1989, $400 million was paid by profitable corporations which also paid some income tax, and $299 million was paid by companies which reported financial losses.

[32] Since $3.3 billion of these profits were allocated to Ontario, an 8 percent minimum tax on the adjusted profits of these non-taxpaying corporations would have raised $264 million in 1989. Additional revenues would have been raised from low-taxpaying companies.

[33] In particular, since most untaxed profits (after adjusting for equity income, inter-corporate dividends, prior years' losses, and the small business tax holiday) are attributable to accelerated write-offs which only allow companies to defer income taxes, it is often argued that any corporate minimum tax should be creditable against subsequent income taxes, at least to the extent that the tax is attributable to accelerated write-offs. While creditability would not affect total revenues in the first year of a corporate minimum tax, it would reduce corporate income tax revenues over time.

Diagram 6:

Adjusted Profits By Industry Sector



Finance - *Includes banks, holding companies, and some real estate operations*
Construction - *Includes general (and other) contractors and some real estate companies*
Services - *Includes personal services and restaurants*
Other - *Includes agriculture, fishing, forestry, mining, retail, transportation, and wholesale companies*

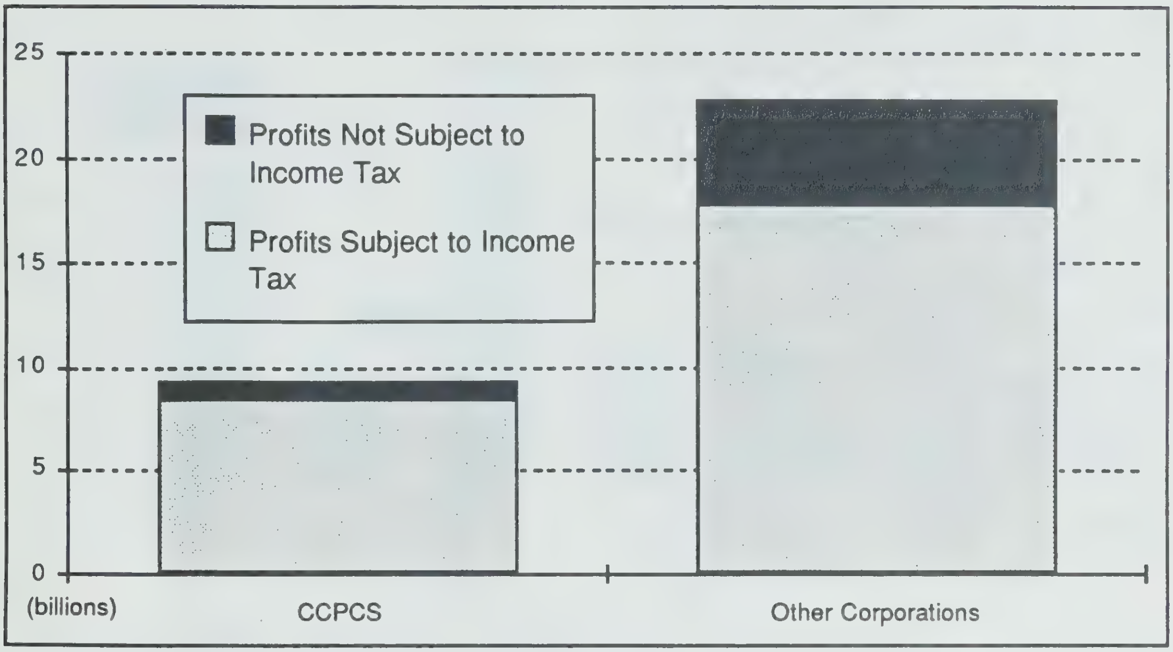
Of $6 billion of profits that were not subject to income tax for reasons other than the small business tax holiday, the application of prior years' losses, the non-taxation of equity income, or inter-corporate dividends, $1.6 billion was earned by roughly 660 manufacturing companies, $1.3 billion was earned by about 70 insurance companies, $900 million was earned by 730 construction and real estate companies, $650 million was earned by 2100 finance companies, $600 million was earned by 860 service corporations, $450 million was earned by companies in other sectors, and $500 million was earned by companies which did not specify their industry sector.

In comparison, of the $32.1 billion in adjusted profits* earned by roughly 104,000 profitable companies which did not benefit from the small business tax holiday, $9.1 billion was earned by roughly 9000 manufacturing companies, $2.8 billion was earned by 200 insurance companies, $4 billion was earned by 15,000 construction and real estate companies, $6.4 billion was earned by 30,000 finance companies, $2.8 billion was earned by 11,600 service corporations, $4.5 billion was earned by 24,400 companies in other sectors, and $2.5 billion was earned by 13,800 companies which did not specify their industry sector.

* Adjusted profits = profits per financial statements less equity income, inter-corporate dividend income and prior years' losses.

Diagram 7:

Adjusted Profits By Company Type



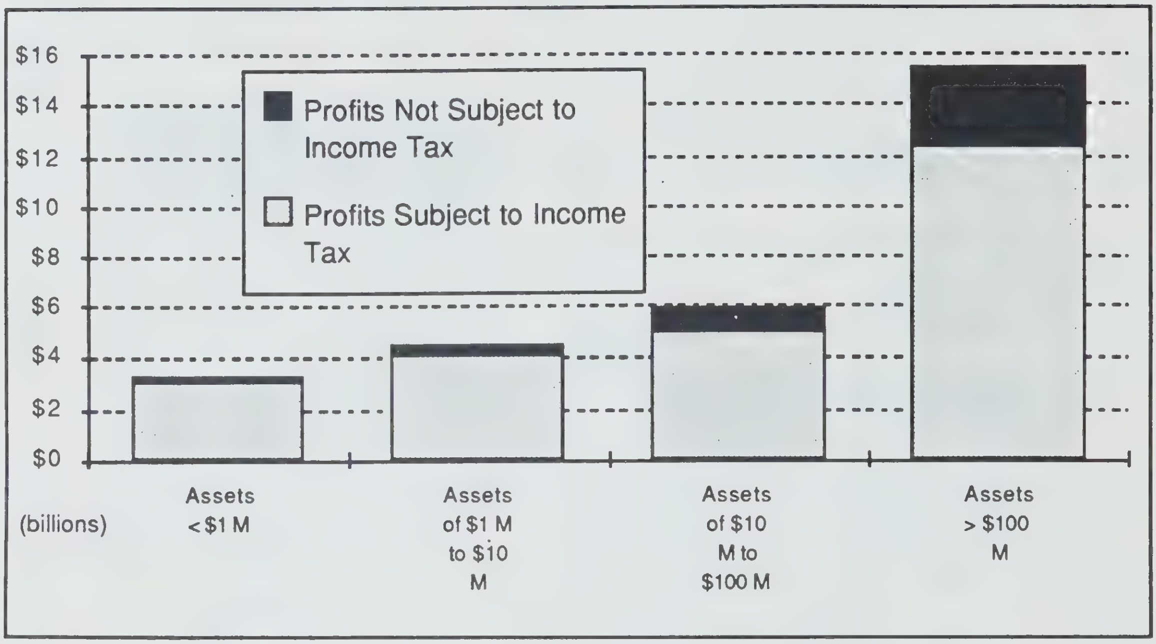
Of $6 billion of profits that were not subject to income tax for reasons other than the small business tax holiday, the application of prior years' losses, or the non-taxation of inter-corporate dividends and equity income, $1 billion was earned by 5300 Canadian Controlled Private Corporations and $5 billion was earned by 1400 other corporations.

In comparison, of $32.1 billion in adjusted profits* earned by roughly 104,000 profitable companies which did not benefit from the small business tax holiday, $9.3 billion was earned by 97,000 Canadian Controlled Private Corporations and $22.8 billion was earned by 7000 other corporations.

* Adjusted profits = profits per financial statements less equity income, inter-corporate dividend income and prior years' losses.

Diagram 8:

Adjusted Profits By Company Size



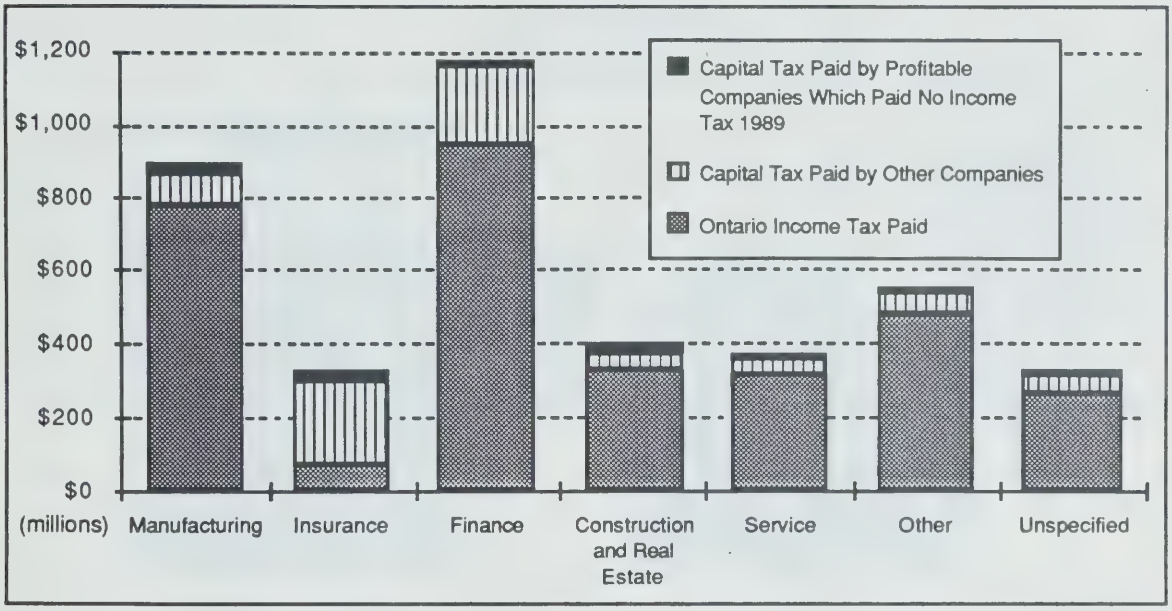
Of the $4.7 billion of non-insurance profits that were not subject to income tax for reasons other than the small business tax holiday, the application of prior years' losses, the non-taxation of equity income, or inter-corporate dividends,* roughly $250 million was earned by 3350 companies with assets of less than $1 million, $400 million was earned by 2550 companies with assets of between $1 million and $10 million, $850 million was earned by 550 corporations with assets of between $10 million and $100 million, and $3.2 billion was earned by about 200 corporations with assets of more than $100 million.

By comparison, after subtracting the $2.8 billion of adjusted profits earned by 200 insurance companies, of $29.3 billion in adjusted profits earned by profitable companies which did not benefit from the small business tax holiday, roughly $3.3 billion was earned by 76,200 companies with assets of less than $1 million, $4.5 billion was earned by 23,100 companies with assets of between $1 million and $10 million, $5.9 billion was earned by 3250 corporations with assets of between $10 million and $100 million, and $15.6 billion was earned by about 850 corporations with assets of more than $100 million.

* No data on the asset size of insurance companies was available for the purpose of this analysis.

Diagram 9:

Capital And Income Taxes Paid By Sector

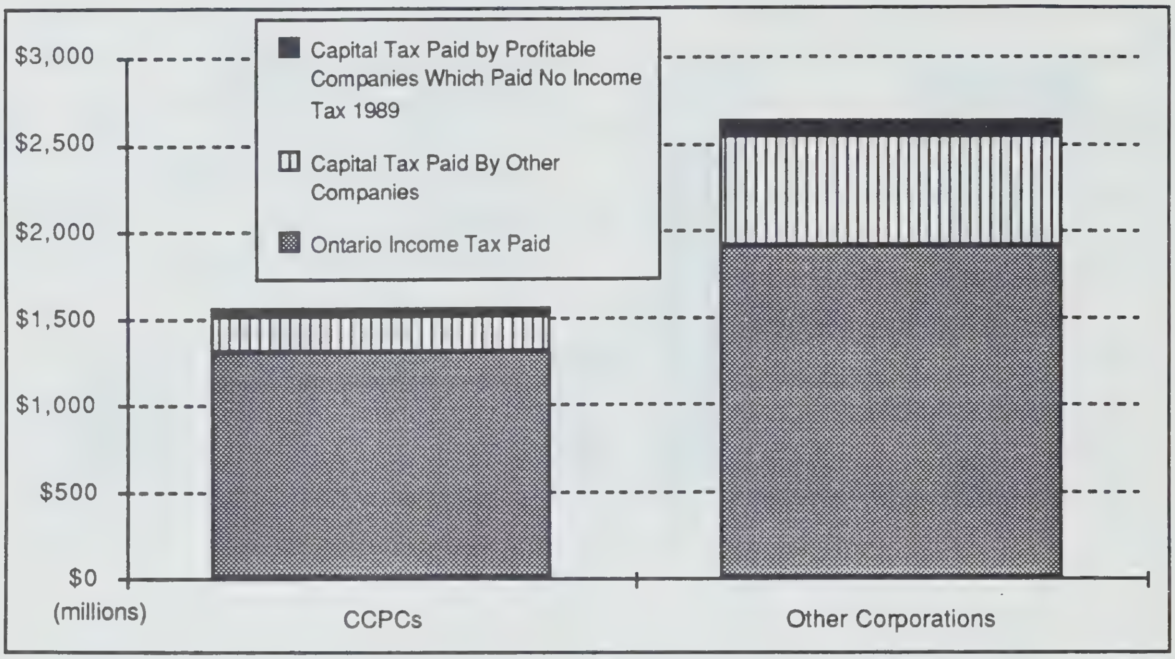


Among the 6700 profitable companies that paid no Ontario income tax in 1989 for reasons other than the small business tax holiday, the application of prior years' losses, or the non-taxation of inter-corporate dividends and equity income, manufacturing companies paid $22 million in Ontario capital taxes, insurance companies paid $30 million in premium taxes, construction and real estate companies paid $12 million in capital taxes, finance corporations paid $25 million, service corporations paid $17 million, companies in other sectors paid $8 million and companies which did not specify their industry sector paid $13 million.

In comparison, of total Ontario corporate income and capital taxes paid in 1989, manufacturing companies paid $780 million in income taxes and $110 million in capital taxes, insurance companies paid $70 million in income taxes and $260 million in premium taxes, construction and real estate companies paid $330 million in income taxes and $70 million in capital taxes, finance companies paid $950 million in income taxes and $225 million in capital taxes, service corporations paid $315 million in income taxes and $60 million in capital taxes, companies in other sectors paid $485 million in income taxes and $65 million in capital taxes, and companies which did not specify their industry sector paid $270 million in income taxes and $60 million in capital taxes.

Diagram 10:

Capital And Income Taxes Paid By Company Type

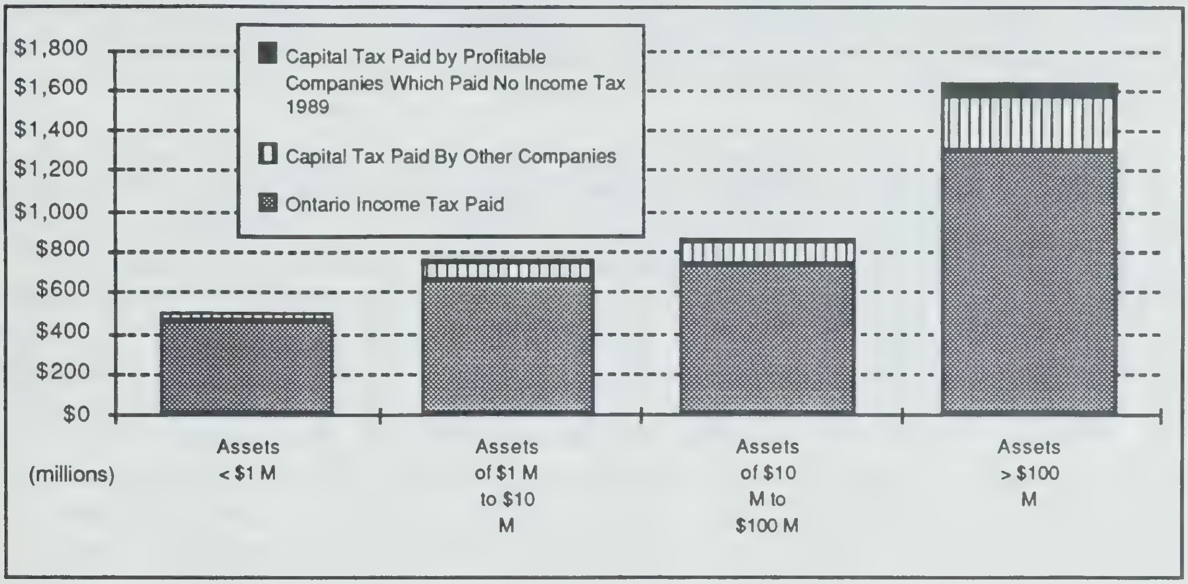


Among profitable companies that paid no Ontario income tax in 1989, for reasons other than the small business tax holiday, the application of prior years' losses, or the non-taxation of inter-corporate dividends and equity income, Canadian Controlled Private Corporations paid $33 million in Ontario capital or premium taxes and other companies paid $94 million.

By comparison, Canadian Controlled Private Corporations paid $1.3 billion in income taxes and $220 million in capital or premium taxes, while other companies paid $1.9 billion in Ontario income taxes and $640 million in Ontario capital or premium taxes in 1989.

Diagram 11:

Capital and Income Taxes Paid By Company Size



Among profitable companies (other than insurance companies) that paid no Ontario income tax in 1989 for reasons other than the small business tax holiday, the application of prior years' losses, or the non-taxation of inter-corporate dividends and equity income, companies with less than $1 million in assets paid $2 million in Ontario capital taxes, companies with assets of between $1 and $10 million paid $8 million, companies with assets of between $10 million and $100 million paid $19 million, and companies with assets of more than $100 million paid $67 million in Ontario capital taxes.

In comparison, of total Ontario corporate income and capital taxes paid in 1989, companies with less than $1 million in assets paid income taxes of $460 million and capital taxes of $20 million, companies with assets of between $1 million and $10 million paid income taxes of $660 million and capital taxes of $95 million, companies with assets of between $10 million and $100 million paid income taxes of $730 million and capital taxes of $140 million, and companies with assets of more than $100 paid $1.3 billion in income taxes and $340 million in capital taxes.

(B) Corporate Taxes and the Overall Tax Burden

In addition to examining evidence on corporations and profits that are subject to little or no income tax, the working group considered historical trends on the relative importance of corporate taxes and personal income taxes as a percentage of total Ontario tax revenues.

As Table 1 indicates, while the personal income tax burden has risen steadily from 30 percent of provincial tax revenues in 1969-70 to almost 50 percent in 1991-92, the percentage of Ontario tax revenues raised from corporate taxes (both income and capital) has declined from almost 20 percent in 1969-70 to less than 10 percent in 1991-92. Moreover, although one declared goal of federal tax reform in 1987 was to increase the contribution of corporate taxes to total federal tax revenues,[34] recent experience in Ontario provides no indication of this result.[35] On the other hand, this result is significantly influenced by the onset of the current recession since 1990-91.

While the working group agreed on the existence of these historical trends, members were divided as to their significance. For some, arguing that corporate taxes fall mainly on high-income taxpayers,[36] a long-term decline in the burden of these corporate taxes could threaten the overall progressivity of the tax system. For these members, a corporate minimum tax represents one way to halt or reverse this trend by restricting one of the causes of this historical decline: the availability of tax incentives through which profitable corporations can reduce their income taxes.

Others rejected this argument on three grounds. First, referring to further evidence on historical trends on corporate and personal incomes relative to gross domestic product [Table 2] and to taxes as a percentage of these corporate and personal incomes [Table 3], it is also evident that a principal reason why corporate taxes have decreased as a percentage of provincial tax revenues has to do with decreased corporate profitability and with other features of the corporate income tax (e.g., partial integration and interest deductibility) that encourage income that might otherwise be subject to corporate tax to be shifted to the personal level.[37] The working group did not agree on the relative impact of these various causes.

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[34] According to federal White Paper on tax reform, corporate tax revenues were to rise from 15.6 percent of total tax revenue in 1987 to 17.2 percent by 1992. Canada: Department of Finance. *White Paper*, p. 64.

[35] Between 1987 and 1992, the percentage of Ontario tax revenues raised from corporate taxes has decreased from 16 percent to 9 percent.

[36] Although this argument rests on the assumption that corporate (income and capital) taxes are ultimately paid by shareholders, it is supported by evidence that, among individual taxpayers, dividend income and capital gains on common shares are overwhelmingly earned by individuals with incomes of $100,000 or more.

[37] By creating a disincentive to the distribution of corporate income in the form of dividends, partial integration encourages owner/managers to withdraw this income in the form of salaries or bonuses which appear in the personal incomes of the owner/managers rather than the corporate incomes of the payor companies. Similarly, by encouraging companies to finance their operations through debt rather

Second, emphasizing other taxes paid by corporations (payroll, property and business, sales and excise, mining and resource royalties), several members questioned whether the historical trends in relative personal and corporate tax burdens would remain once all taxes (not just income and capital) were taken into account. Aside from concerns about the ultimate incidence of these taxes, the working group did not obtain comprehensive data on the aggregate tax burden of the corporate and personal sectors.

Finally, noting that all corporate taxes are ultimately borne by people (consumers, employees, suppliers, or shareholders), several members questioned the relevance of sectoral comparisons to any questions of tax fairness, and responded that the ultimate incidence of the corporate income tax may be no more progressive (or even less progressive) than the personal income tax. Although many economists conclude that in a small open economy like Ontario corporate income and capital taxes tend to be shifted to consumers,[38] the working group was unable to consider in any detail the question of who ultimately bears the burden of the corporate income tax.

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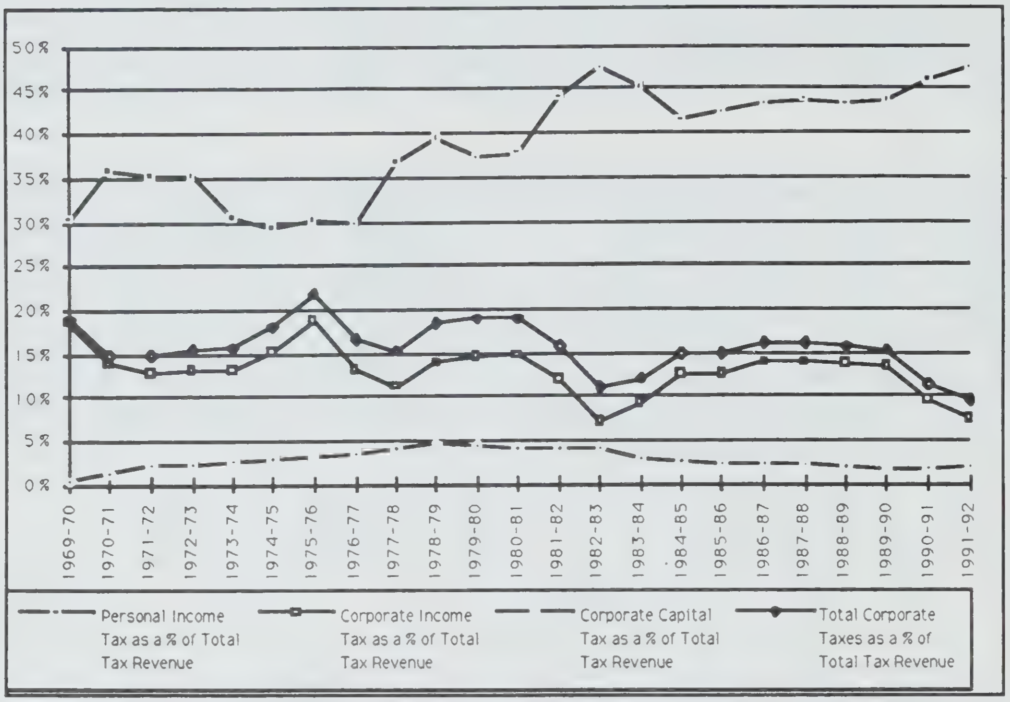
than equity, interest deductibility may cause income that is initially earned by corporations to appear as the interest income of individual taxpayers. Two recent studies emphasize falling profitability as the main reason for the relative decline in corporate income taxes since the 1950s and 1960s. See David Perry, "The Relative Importance of Personal and Corporate Income Taxation," pp. 460-67; and Alan Douglas, "Changes in Corporate Tax Revenue," pp. 66-81.

38 This is especially so in the case of large public companies with a high degree of international capital mobility. In the case of smaller private companies, the incidence of corporate income and capital taxes is more likely to fall on corporate owners.

Table 1: Corporate Taxes and Personal Income Taxes as a % of Provincial Tax Revenue

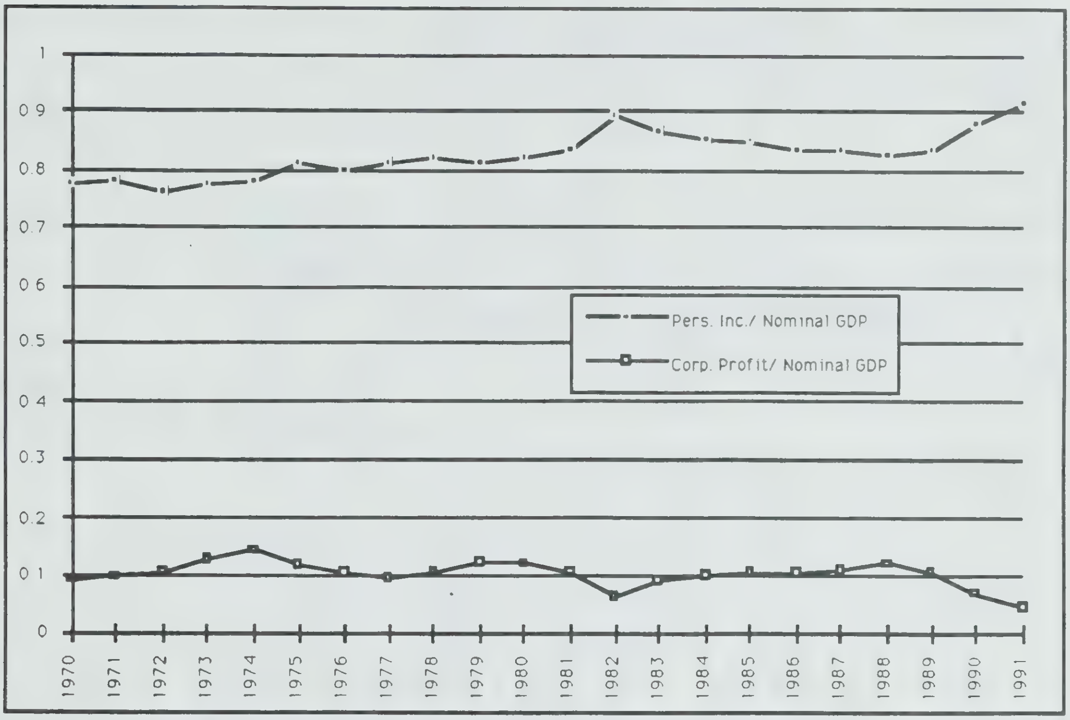


Year	Total Provincial Tax Revenue	Personal Income Tax	Personal Income Tax as a % of Total Tax Revenue	Corporate Income Tax	Corporate Income Tax as a % of Total Tax Revenue	Corporate Capital Tax	Corporate Capital Tax as a % of Total Tax Revenue	Total Corporate Taxes	Total Corporate Taxes as a % of Total Tax Revenue
1969-70	2,523	762	30%	468	19%	9	0%	477	19%
1970-71	2,754	992	36%	382	14%	32	1%	414	15%
1971-72	2,901	1,022	35%	370	13%	63	2%	433	15%
1972-73	3,414	1,205	35%	448	13%	79	2%	527	15%
1973-74	4,067	1,236	30%	530	13%	108	3%	638	16%
1974-75	4,953	1,445	29%	753	15%	139	3%	892	18%
1975-76	5,205	1,571	30%	976	19%	164	3%	1,140	22%
1976-77	6,006	1,782	30%	791	13%	211	4%	1,002	17%
1977-78	6,652	2,447	37%	743	11%	271	4%	1,014	15%
1978-79	6,946	2,735	39%	964	14%	314	5%	1,278	18%
1979-80	8,558	3,183	37%	1,247	15%	369	4%	1,616	19%
1980-81	9,449	3,578	38%	1,397	15%	395	4%	1,792	19%
1981-82	11,136	4,928	44%	1,322	12%	447	4%	1,769	16%
1982-83	12,364	5,858	47%	875	7%	486	4%	1,361	11%
1983-84	13,247	5,994	45%	1,210	9%	373	3%	1,583	12%
1984-85	15,092	6,253	41%	1,859	12%	389	3%	2,248	15%
1985-86	17,144	7,249	42%	2,159	13%	416	2%	2,575	15%
1986-87	19,958	8,618	43%	2,755	14%	450	2%	3,205	16%
1987-88	22,480	9,859	44%	3,109	14%	491	2%	3,600	16%
1988-89	26,997	11,687	43%	3,690	14%	533	2%	4,223	16%
1989-90	31,015	13,518	44%	4,139	13%	581	2%	4,720	15%
1990-91	33,612	15,440	46%	3,166	9%	632	2%	3,798	11%
1991-92	33,597	15,975	48%	2,492	7%	678	2%	3,170	9%

Note: Figures quoted are in millions of dollars

SOURCE: Ontario Budgets 1969-1991

Table 2: Corporate Profits and Personal Income as a % of GDP

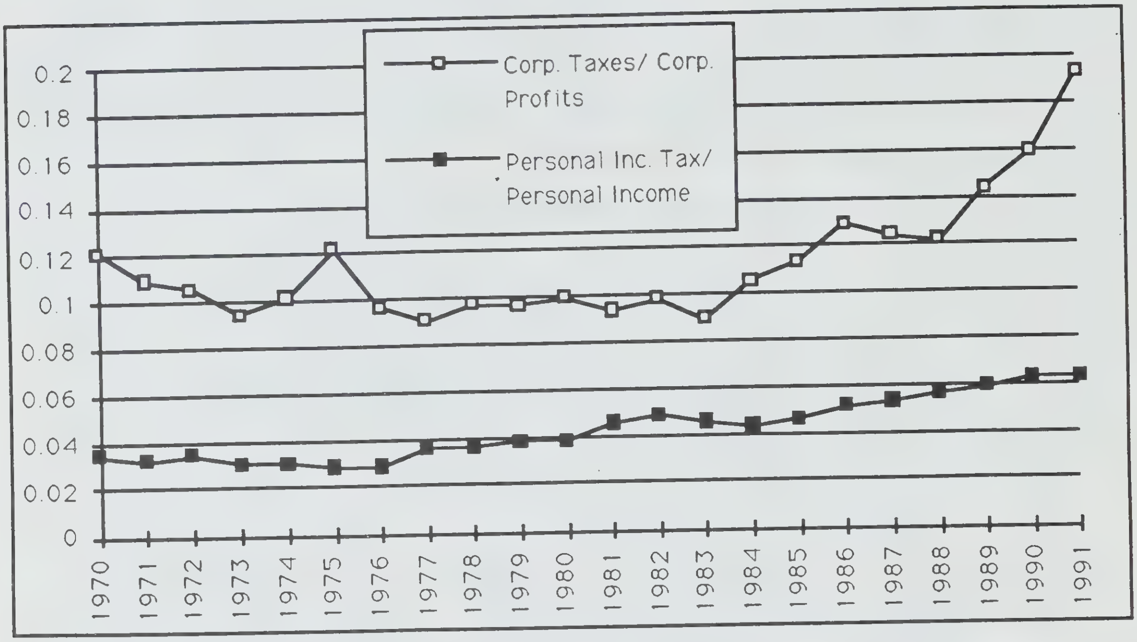


Year	Nominal GDP	Personal Income	Pers. Inc./ Nominal GDP	Corp. Profit Before Tax	Corp. Profit/ Nominal GDP
1970	37,131	28,766	77%	3,430	9%
1971	40,575	31,581	78%	3,974	10%
1972	46,718	35,585	76%	5,021	11%
1973	52,736	40,910	78%	6,755	13%
1974	61,599	48,011	78%	8,807	14%
1975	68,164	55,167	81%	8,023	12%
1976	78,188	62,556	80%	8,242	11%
1977	84,662	68,598	81%	8,177	10%
1978	92,414	75,832	82%	9,915	11%
1979	104,363	84,607	81%	12,978	12%
1980	114,994	94,411	82%	14,099	12%
1981	131,631	110,033	84%	14,169	11%
1982	137,310	122,443	89%	8,944	7%
1983	151,945	131,947	87%	13,557	9%
1984	171,499	146,193	85%	17,656	10%
1985	183,561	156,293	85%	19,116	10%
1986	202,710	169,608	84%	21,293	11%
1987	224,257	186,967	83%	24,988	11%
1988	252,887	208,460	82%	30,365	12%
1989	272,298	227,910	84%	28,858	11%
1990	277,740	245,048	88%	19,855	7%
1991	278,190	255,507	92%	12,930	5%

Note: Figures quoted are in millions of dollars

Source: Statistics Canada August 1988, Ontario Economic Accounts January, 1992

Table 3: Corporate Taxes and Personal Income Taxes as a % of Their Respective Incomes



Year	Corp. Taxes	Corp. Profit Before Taxes	Corp. Taxes/ Corp. Profits	Personal Inc. Tax	Personal Income	Personal Inc. Tax/ Personal Income
1970	414	3,430	12%	992	28,766	3%
1971	433	3,974	11%	1,022	31,561	3%
1972	527	5,021	10%	1,205	35,585	3%
1973	638	6,755	9%	1,236	40,910	3%
1974	892	8,807	10%	1,445	48,011	3%
1975	976	8,023	12%	1,571	55,167	3%
1976	791	8,242	10%	1,782	62,556	3%
1977	743	8,177	9%	2,447	68,598	4%
1978	964	9,915	10%	2,735	75,832	4%
1979	1,247	12,978	10%	3,183	84,607	4%
1980	1,397	14,099	10%	3,578	94,411	4%
1981	1,322	14,169	9%	4,928	110,033	4%
1982	875	8,944	10%	5,858	122,443	5%
1983	1,210	13,557	9%	5,994	131,947	5%
1984	1,859	17,656	11%	6,253	146,193	4%
1985	2,159	19,116	11%	7,249	156,293	5%
1986	2,755	21,293	13%	8,618	169,608	5%
1987	3,109	24,988	12%	9,859	186,967	5%
1988	3,690	30,365	12%	11,687	208,460	6%
1989	4,139	28,858	14%	13,518	227,910	6%
1990	3,166	19,855	16%	15,440	245,048	6%
1991	2,492	12,930	19%	15,975	255,507	6%

Note: Figures quoted are in millions of dollars

Source: Statistics Canada, August 1988, Ontario Economic Accounts January, 1992, Ontario Budgets 1970-1991

(C) Corporate Taxes and the Economy[39]

It is often said that policy-making requires a degree of distance from the immediate context in which decisions are made. Throughout their deliberations, however, members of the working group were acutely aware of the difficult economic circumstances currently facing the Ontario economy.

It is generally agreed that the current recession in Ontario is at least as severe as 1982 and perhaps the worst since the 1930s. The province's real gross domestic product fell by 1.9 percent in 1991, after dropping 0.8 percent in 1990. Pre-tax corporate profits reported in Ontario dropped 27.5 percent and real business investment in Ontario fell 6.9 percent. From February 1990 to February 1991, total employment in Ontario fell by 260,000. From April 1990 to June 1991, the provincial unemployment rate rose from 5.2 percent to 10.2 percent.

It is also generally agreed that the effects of the recession have been considerably more severe in Ontario than elsewhere in Canada. Although Ontario accounts for 38 percent of the national labour force, the province accounted for 80 percent of jobs lost in Canada between February 1990 and February 1991. While jobs have been lost in Ontario and Quebec during this period, employment has increased in Alberta and British Columbia.

Further, it is generally acknowledged that the impact of the recession in Ontario is compounded by underlying structural adjustments affecting the character of the provincial economy. Partly due to the Free Trade Agreement, partly due to low productivity growth during the 1980s and partly because of federal policies that have supported high exchange rates and high real interest rates, Ontario is facing increased international competition, especially in relatively mobile industries like light manufacturing.

One indicator of the nature of the changes that have taken place, particularly in Ontario, is the fact that more manufacturing jobs have been lost and a much higher proportion of those losses has been permanent in this recession than was the case in the 1982 recession. For example, in 1990, 20,554 workers lost their jobs in permanent plant closures involving at least 50 workers. In 1982, permanent shutdowns were responsible for only 11,150 jobs lost. In 1990, 65 percent of job losses were permanent, compared to only 24 percent in 1982. Of the 260,000 jobs lost in Ontario between February 1990 and February 1991, 153,000 (almost 60 percent) were in the the manufacturing sector.

It is also understood that the recession has had a serious impact on the well-being of many Ontarians, and on the fiscal capacity of the provincial government. More than 100,000 workers have been looking for jobs for more than six months. Projected high unemployment rates through the mid-1990s suggest that the numbers of long-

[39] Statistics included in this section are drawn from Ontario: Ministry of Treasury and Economics, *The Ontario Budget 1991* and *The Ontario Economic Outlook 1992*.

term unemployed are likely to remain high for the immediate future. Due in part to changes in federal Unemployment Insurance regulations that have caused some workers to exhaust their U.I. benefits sooner than they would have under the old rules, the number of Ontarians receiving social assistance has increased dramatically. The cost of social assistance has doubled in the last two fiscal years, from $2.6 billion in 1989-90 to an estimated $5.3 billion in 1991-92.

At the same time as these expenditure requirements have increased, revenues have fallen. Personal income taxes are projected to decline by $1 billion in 1992. Corporate income taxes fell in 1990 and again in 1991 and are expected to recover slowly, since corporations can carry current losses forward to offset future profits.

The April 1991 budget projected a $9.7 billion deficit, the largest in the province's history. In order to maintain current spending commitments, the provincial government would have to revise its projected deficit for 1992-93 from $8.9 billion to $14.3 billion. The government has indicated that it is unwilling to let the deficit reach this level.

For members of the working group, the current economic environment posed a dilemma. On the one hand, members appreciated the need for government revenues to help disadvantaged Ontarians weather the recession and to finance education and retraining programs to help the workforce adjust to the more competitive economic environment of the 1990s. Many members agreed that if tax increases were necessary to address the deficit, the government could not be expected to impose an additional burden on the personal sector without also increasing taxes on the corporate sector. On the other hand, many members were also anxious that introducing a corporate minimum tax, especially at this time, might only deepen the recession by undermining business confidence and encouraging businesses to relocate to more competitive environments in other provinces or south of the border.

These questions of structural adjustment and economic competitiveness involve complex issues to which the Group could devote only limited attention. Although it did not consider any evidence on the impact of government expenditures on economic competitiveness, it examined statutory corporate tax rates in neighbouring jurisdictions, and considered the results of two studies comparing corporate taxes in Ontario to those of competing jurisdictions in Canada and the United States. In addition, via individual members and submissions, the Group was made aware of recent studies suggesting that, although still comparable to the United States, the tax competitiveness of Canada's manufacturing sector was substantially eroded by federal tax reform in 1987.[40]

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[40] See Patrick Grady, "Real Effective Corporate Tax Rates in Canada and the United States After Tax Reform;" Tancredi Zollo and Stelios Loizides, *Canada-U.S. Tax Competitiveness in Manufacturing Industries*, (July 1990); and Ken Mackenzie and Jack Mintz, "Tax Effects on the Cost of Capital: A Canadian-United States Comparison," in John Shoven and John Whalley, eds., *Canada-U.S. Tax*

Because they ignore differences in allowable deductions, statutory rates are often dismissed as irrelevant to actual business location and investment decisions. On the other hand, to the extent that these decisions are based on perceptions, several members of the Group suggested that statutory rates may be more significant than is often assumed. In any event, although the general corporate income tax rate in Ontario is the highest of the eight jurisdictions surveyed, the statutory rates for manufacturing and small business are not significantly different from any of these jurisdictions except Quebec (which has lower income taxes, but higher capital taxes).

These conclusions are not inconsistent with the two studies considered by the Group. The first, a case study approach prepared by the Taxation Policy Branch of the Ontario Ministry of Treasury and Economics, compares the relative tax burden on sample firms in twelve industries in Ontario, Quebec, and selected U.S. states.[41] The second, prepared by Jack Mintz (a member of the working group and professor of business economics at the University of Toronto), compares effective corporate (income and capital) tax rates in each Canadian province as these are applied to new capital investments in particular industries and assets.[42]

According to the former, although the mix of corporate taxes may differ significantly,[43] when all corporate taxes are taken into account, the tax burden faced by a model Ontario firm is not significantly out-of-line with the average tax burden faced by similar firms in the other jurisdictions studied. According to the latter, although the taxation of most industries in Ontario is roughly comparable to that in other provinces,[44] overall effective tax rates are higher in Ontario than in any other province, due mainly to the fact that manufacturing—the third highest-taxed industry in Canada—figures so prominently in the Ontario economy.

In response to this information, members of the working group had two general kinds of comments. First, with regard to the issue of tax competitiveness, members emphasized several points that should be considered in making any such comparisons:

Comparisons, (Chicago: University of Chicago Press, forthcoming). These results will be significantly affected by proposals in the recent federal budget to decrease the federal tax rate on manufacturing and processing income and to increase the capital cost allowance for investments in manufacturing and processing equipment.

41 Ontario: Ministry of Treasury and Economics, "Corporate Tax Comparisons: A Case Study Approach." This document and a supporting slide presentation were prepared on the basis of technical studies conducted by the accounting firm of Price Waterhouse.

42 Duanjii Chen and Jack Mintz, "Taxation of Capital in Canada: An Interindustry and Interprovincial Comparison."

43 Specifically, Ontario tends to rely more heavily on corporate income taxes and less on taxes on business inputs than other jurisdictions.

44 Rates are generally lower in the Atlantic provinces on account of federal investment tax credits which apply only to investments in that region. Rates are also consistently lower in Quebec on account of its low statutory corporate income tax rate.

- It is not an average rate in number of other jurisdictions that matters to tax competitiveness but the lowest rate in a single competing jurisdiction. In particular, some members emphasized the importance of Quebec as Ontario's major competitor.

- Although a proper comparison of the corporate tax burden in competing jurisdictions requires some consideration of the incidence of different corporate taxes, it is essential to consider the total tax burden (not just income, or income and capital) on corporations, not just partial tax burdens.

- There is a distinction between the impact of tax rates on where companies choose to locate and where they report income.

- In considering the impact of competitiveness, it is crucial to pay particular attention to the impact that taxes may have on more mobile industries and factors of production, such as manufacturing.

- A fair comparison should also consider additional costs (like health care premiums in the United States) that are reflected in the Ontario tax burden because services are provided through the public rather than the private sector.

- Taxes are only one of several cost factors that influence business location and investment decisions, and not a major cost according to most surveys. Ultimately, it is after tax rates of return that affect these decisions, and these rates may be determined more by labour costs, and locational advantages than by taxes.

- It is also important to consider the full list of benefits that governments provide through tax revenues when considering the impact of taxes on competitiveness. If higher taxes support a healthier and more productive work force or a better transportation system, companies may be willing to pay these taxes to obtain the benefits.

Second, observing that the focus of the Group should be on questions of tax competitiveness as they relate to a corporate minimum tax, members emphasized four main points:

- Since a corporate minimum tax would not increase taxes for firms already paying the minimum amount, it is important to address competitiveness concerns mainly in the context of firms which could be adversely affected. Further, to the extent that it limits the use of certain tax preferences such as those for research and development, it is important to consider the impact that this might have on the competitiveness of sectors which make significant use of these preferences.

- When considering the possibility of firms relocating south of the border, it is important to remember that the United States (as well as several individual states) imposes an alternative minimum income tax on corporations.[45]

- Although the introduction of a corporate minimum tax would on its own probably not cause a business to relocate, it might be one of several factors that could lead firms to leave the province. In particular, members emphasized the sensitivity of business investment and location decisions to confidence in the business environment.

- On the other hand, several members suggested that to the extent that corporations might respond to potentially erroneous perceptions about taxes, it is important to address these perceptions by explaining the real impact of a corporate minimum tax, not by rejecting a tax solely because of the perceptions it may generate.

[45] On the other hand, it was also noted that the Bush administration has proposed changes to the Alternative Minimum Tax that would reduce its impact.

III. Evaluation of a Corporate Minimum Tax

The idea of a corporate minimum tax is quite familiar from recent tax reform exercises in Canada and the United States. It was considered and rejected by the federal government of Canada when it reformed the corporate income tax system in 1987.[46] A corporate minimum tax was first enacted in the United States in 1969 but was substantially amended in 1986. In addition, according to a recent World Bank study, 21 of 99 countries covered in the 1989 Price Waterhouse Worldwide Summary of Corporate Taxes have taxes with the some of the characteristics of a corporate minimum tax.[47]

Consequently, it was with the benefit of this experience that the working group was able to consider both arguments for and against the introduction of a corporate minimum tax, and alternative methods of designing a corporate minimum tax should the Government of Ontario decide to introduce such a tax.

(A) Arguments For and Against a CMT

Based on the data obtained, an investigation of the existing corporate tax system, and an overview of the current economic climate in Ontario, members of the working group considered several possible arguments for the introduction of a corporate minimum tax. These can be broadly categorized as revenue concerns, efficiency arguments, and fairness considerations. The following sections examine arguments both for and against a corporate minimum tax based on these three rationales.

Revenue

For some members, the existence of a large pool of untaxed corporate profits constitutes an appropriate source of additional tax revenues to finance government programs, deficit reduction, or reductions in the share of personal taxes on income or consumption. Emphasizing the declining share of corporate income tax revenues as a proportion of total government revenues that was outlined in Part II of this report, this view identifies corporate tax preferences as a central cause of this decline and regards a corporate minimum tax as an appropriate means of halting or reversing this historical trend. In addition, a corporate minimum tax is proposed as a way of stabilizing corporate tax revenues which can fluctuate considerably over the course of the business cycle. This rationale might suggest either an alternative minimum tax on a revised income base, probably with limits on the extent to which losses from other years can reduce annual income taxes, or a paid-up capital tax like

[46] Canada: Department of Finance, *Supplementary Information Relating to Tax Reform Measures*, p. 53. In contrast, an alternative minimum tax on personal income was introduced by the federal government in 1986. See Canada: Department of Finance, *A Minimum Tax for Canada*.

[47] Estache.

the federal Large Corporations Tax which is largely insensitive to variations in corporate profitability.

Many working group members rejected this argument as a primary rationale for a corporate minimum tax. In addition to specific issues of fairness regarding the potential base of such a tax, considerations to which subsequent sections of this discussion shall return, these members insisted that a fair corporate minimum tax should be limited to redistributing the already existing tax burden to ensure that profitable non-taxpaying companies pay at least some tax.

Further, referring to the data presented in Part II, several members observed that a key reason for the declining share of corporate income taxes as a proportion of total government revenues is a recent decline in corporate profits as a share of gross domestic product. Moreover, although a definitive assessment of the ratio of corporate to personal taxes would require a detailed analysis of the effective incidence of alternative taxes, it was emphasized that a fair evaluation of the relative tax burden on each sector would at the very least have to consider all taxes paid by corporations (e.g., property, payroll, sales and capital), not just corporate income taxes.

Efficiency

A second argument for a corporate minimum tax emphasizes its potential to enhance economic efficiency by reducing variations in effective tax rates among different business entities and across different sectors of the economy. To the extent that capital markets allocate resources to their highest valued (most efficient) uses, it is argued, a corporate minimum tax could increase overall economic efficiency by constraining the impact of existing corporate tax incentives that distort market allocations of capital. In addition, one might suggest, by relieving pressures on governments to enact higher corporate income tax rates to raise additional revenue, a corporate minimum tax might lessen economic distortions (e.g., tax induced mergers, and disincentives to invest in high-risk activities) that are attributed to a corporate income tax system in which losses are not refundable in the year incurred. This approach could also support an alternative minimum tax on a revised income base.

Several arguments might be raised against this efficiency rationale for a corporate minimum tax. First, depending on its actual design, a corporate minimum tax could create inefficiencies of its own. Aside from the potential costs of compliance and avoidance associated with any new corporate tax (particularly one enacted only in Ontario), a corporate minimum tax that limited opportunities to offset losses could have a disproportionate impact on risky investments, start-up firms, and industries with fluctuating profits.

Second, to the extent that these views on the efficiency of capital markets and the inefficiencies of high statutory corporate tax rates are valid, they are less reasons *for* introducing a corporate minimum tax than they are arguments *against* the existence of any corporate tax incentives designed to encourage investment in a particular region, form, or type of enterprise.

Finally, it is by no means obvious that market allocations of capital are necessarily more efficient than government-induced investments, nor that efficient investments invariably meet all economic and social policy objectives. On the contrary, economists themselves emphasize the importance of government incentives to counteract so-called "market failures" that may impede the availability of capital for small businesses and the initiation of uncertain investments in both scientific research and development and resource exploration and development. In addition, federal and provincial governments in Canada have traditionally used the tax system to encourage specific policy objectives like economic development in economically disadvantaged regions of the country,[48] or investment in pollution control equipment.[49]

In sum, as more than one member of the Group emphasized, the tax system has consistently and legitimately been used to advance economic and social policy objectives, and should not be prevented from doing so in the future.

Fairness

A third series of arguments for a corporate minimum tax invoke ideas of fairness. In this regard, at least three distinct lines of argument have been advanced. First, it is said, all corporations should be required to pay at least a minimum amount of tax based upon their ability to pay as determined by profits reported in annual financial statements. Second, some maintain that to the extent that corporations benefit from public investments in the social and physical infrastructure that enables them to operate, they should pay at least a minimum amount of tax in recognition of these benefits received. Finally, others argue that in a system such as Canada's where the corporate income tax is conceived as a withholding tax on the corporate source income of individual shareholders (so that individual taxpayers receive a tax credit for dividends received, and inter-corporate dividends flow free of tax), a corporate minimum tax may be necessary to ensure that these recipients of corporate income, among whom high-income taxpayers are disproportionately represented, cannot defer taxes on income retained by corporations, and cannot avoid taxes on corporate income that is ultimately distributed to them as dividends.

These rationales reflect traditional tax policy principles regarding horizontal equity, taxation according to benefits received, and vertical equity or taxation according to ability to pay.

(1) Horizontal Equity

The principle of horizontal equity declares that taxpayers in similar economic circumstances should bear a similar tax burden. If corporations' economic circum-

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[48] This policy objective was reiterated in the recent federal tax reforms, which preserved existing investment tax credits for the Atlantic region and slow growth regions. Canada: Department of Finance, *Supplementary Information Relating to Tax Reform Measures.*

[49] Despite eliminating the Ontario Capital Cost Allowance for investment in manufacturing and processing equipment after 1991, the Ontario government has preserved this incentive for investments in pollution control equipment.

stances were adequately reflected in their annual financial statements, horizontal equity might suggest that those with reported profits should pay at least a minimum amount of tax on this income.

Most working group members rejected this notion of horizontal equity. First, members noted that legitimate economic and social policy objectives might justify differential tax treatment for different sectors or types of firms: market failures could support tax incentives for small businesses, research and development, and exploration and development; specific policy objectives may favour tax incentives for regional economic development or investment in pollution control equipment; and international (or inter-provincial) competition might suggest special treatment for relatively mobile factors of production. In other words, all investments and all corporations are not alike.

Second, members generally agreed that legitimate economic and tax policy considerations support key characteristics of the corporate income tax system that distinguish between annual financial statement income and income for the purposes of corporate income tax. The annual income of a firm that has experienced a number of profitable years is not the same as a similar annual amount for a company recovering from a series of years with losses; nor are dividends which have already borne a full measure of tax at the level of the distributing company the same as profits which have yet to be taxed. In other words, all corporate income is not alike.

Finally, most members reject the argument that a corporate minimum tax on financial statement income is necessary if only to address the ***perceived*** injustice of profitable companies paying little or no tax in any given year—a perceived unfairness that could undermine public confidence in the tax system and contribute to noncompliance among taxpayers. Although perceptions of fairness can be crucial to a system of self-assessed taxation, most members would prefer to confront these perceptions through a process of public education, not by introducing a corporate minimum tax based partly or wholly on financial statement income.

(2) Corporate Taxes and Benefits Received

A second principle of tax fairness suggests that corporations should pay at least a minimum amount of tax toward public investments in the social and physical infrastructure from which they benefit. A healthy and educated workforce, an efficient communication and transportation system, a clean and safe environment, and a legal system in which property rights, contractual obligations and the institution of limited liability are upheld—these are public goods from which both individuals and firms benefit, and for which corporations should be and are (within a framework of international and inter-provincial competition) willing to pay.

Most members of the working group agree with this principle and the notion that corporations have an obligation to contribute to the public goods from which they benefit. Nonetheless, there are at least two replies to this benefits received principle as an argument for the introduction of a corporate minimum tax.

First, it is said, in addition to private investments in skills training and voluntary contributions to charities, universities and the arts, corporations already pay a variety of taxes for the public goods just mentioned: property taxes contribute to municipal services and public education; payroll taxes such as Ontario's new Employer Health Tax help ensure a healthy and productive workforce; excise taxes help maintain the Province's roads and environment; and the paid-up capital tax imposes an annual levy on all corporations with assets of $1 million or more. In each respect, several members have said, corporations already pay "minimum" taxes for many of the benefits they receive.

Second, many members add, in a competitive environment where many firms can shift operations to other jurisdictions, there are limits to the tax burden that a corporation will bear before it chooses to relocate to another province or country. Although the issue of tax competitiveness is a complex one which the working group cannot claim to have examined in any detail, the frequency of recent plant closures in Ontario causes many members to wonder whether the current cost of Ontario's public goods is already out of balance with the benefits that corporations receive. As a result, it is feared, the introduction of a new corporate minimum tax, especially at this time, might only compound the economic disruption that the Province is currently experiencing.

For other members of the working group, one or both of these replies is unconvincing. First, it is said, although corporations do already pay a variety of taxes, the current state of the Provincial budget requires that all taxpayers—individual and corporate alike—contribute more resources to the pressing task of deficit reduction. Second, it is argued, although the Ontario economy undoubtedly faces a period of significant economic restructuring, the optimal route to sustainable prosperity lies not in reducing taxes to the level of the lowest common denominator, but instead through adopting an industrial strategy to foster a high wage/high value-added economy in which the benefits of economic development are more widely shared.

(3) Vertical Equity and Ability to Pay

A third fairness argument for a corporate minimum tax relates to the dual functions of the corporate income tax as a withholding tax on corporate source income and as an instrument of economic and social policy. On the one hand, by taxing profits at the level of the corporation itself, the corporate income tax ensures that domestic shareholders cannot defer income tax by leaving profits in the corporation and that foreign shareholders (and governments which credit shareholders for Canadian taxes paid) cannot avoid tax payments to the Canadian government. On the other hand, by containing deliberate incentives to encourage investment in specific assets, industries or regions, the corporate income tax may allow not only the very deferral of taxes that its withholding function is designed to prevent, but also the permanent avoidance of tax by recipients of dividends who also obtain tax credits for income which has borne little or no tax. To the extent that a disproportionate amount of corporate income is earned by high-income taxpayers, therefore, the economic and social policy function of the corporate income tax may contradict the cardinal prin-

ciple of a progressive income tax: that taxation should be based on the taxpayer's ability to pay.

In this light, a minimum tax that limits the extent to which a corporation can employ tax preferences to pay little or no income tax can be viewed as a means of expressing and accommodating the conflicting values at work in a pluralistic corporate income tax. On the one hand, by maintaining (but limiting) the use of corporate tax incentives, a minimum corporate income tax acknowledges the important role that the corporate income tax serves as an instrument of social and economic policy. On the other hand, by limiting the extent to which any single profitable corporation can employ these incentives to reduce its tax liability, such a tax ensures that domestic and foreign shareholders cannot completely defer or avoid tax on corporate source income, but instead must pay at least a minimum amount of tax on this income, regardless of whether it is retained by the corporation or distributed as dividends. In this respect, a corporate minimum tax can be viewed as a complement to the alternative minimum tax on personal income introduced by the federal government in 1986.[50]

To this argument for a minimum corporate income tax, many members of the working group raised two main objections: first, that by eliminating or sharply curtailing several corporate income tax incentives introduced in the 1970s and 1980s, recent federal tax reforms have largely eliminated the problem of profitable corporations paying little or no tax, thereby restoring the withholding function of the corporate income tax; second, that especially in light of these reforms, the anticipated benefits of a minimum tax on corporate income (in terms of both enhanced equity and increased revenue) cannot justify the potential costs (administration, compliance, transition, and economic impact) associated with its introduction.

The resolution of this disagreement is exceedingly difficult in the absence of reliable data on the number of corporations paying little or no tax (and the amount of untaxed or under-taxed corporate profits) under the post-reform corporate income tax, and on the potential costs and benefits (both revenue and enhanced vertical equity) of an optimally designed minimum tax on corporate income. Nonetheless, even admitting these limitations, four points might be raised in response.

First, although federal tax reform did eliminate or curtail a number of corporate tax preferences (and increased the amount of income tax paid by financial institutions, partly by preventing corporations with substantial accumulated losses from trading these losses through after-tax preferred share financing), it nevertheless left several such provisions in place: all corporate rates were lowered, but favourable rates continue for small business and manufacturing; accelerated capital cost allowances were curtailed, but retain an acknowledged "incentive element"[51]; a 25% capital gains exemption remains (down from 50% before tax reform); and previously existing in-

[50] See Canada: Department of Finance, *A Minimum Tax for Canada*, pp. 28, 39. See also Michael Graetz and Emil Sunley, "Minimum Taxes and Comprehensive Tax Reform," p. 393.

[51] Canada: Department of Finance, *White Paper*, p. 59.

centives were generally retained for research and development and for resource exploration and development.

Second, in addition to these enduring federal provisions, the Ontario government introduced additional preferences prior to and after federal tax reform, including a three-year tax holiday for new small businesses and added deductions for new manufacturing and processing or pollution control equipment purchased for use in Ontario (the Ontario Current Cost Adjustment) and for research and development (the Ontario Research and Development Super Allowance). While the small business tax holiday was phased out beginning in 1988 and the Ontario Capital Cost Allowance applies only to pollution control equipment after 1991, these other incentives are likely to enable some profitable firms to pay little or no corporate income tax in Ontario.

Third, while limitations on post-reform data make it impossible to reach any definitive conclusions on the impact of tax reform, information considered by the working group suggests that even after tax reform a number of profitable corporations are able to use these remaining incentives to pay little or no corporate income tax.

Finally, although the revenue raised by a corporate minimum tax would necessarily depend on its actual design, the continuation of these various corporate tax incentives suggests that the revenue raised by a minimum corporate income tax might not be insubstantial.

Conclusions

Despite agreeing on the basic arguments ***for*** and ***against*** a corporate minimum tax, the working group did not agree on whether or not Ontario ***should*** introduce a corporate minimum tax. Nevertheless, in light of the Treasurer's request for advice on the ***design*** of a corporate minimum tax, the Group also considered alternative options for such a tax. The results of these efforts and the conclusions reached by the Group are presented in the next section.

(B) Design Options for a Corporate Minimum Tax

If the Provincial Government decides to introduce a corporate minimum tax, how should it be structured? The Corporate Minimum Tax Working Group devoted much attention to this question, reviewing alternative options and design features for a corporate minimum tax (CMT), considering the U.S. experience with its Alternative Minimum Tax, and developing criteria to govern the choice among CMT options and design features.

This section presents the results of these efforts, outlining the main criteria that the Group has employed to assess alternative options and design features, reviewing the options and design features that the Group considered, and indicating the outcome of group discussions on each of these topics.

Design Criteria

The Treasurer asked the Corporate Minimum Tax Working Group to provide advice on the design of an "effective" corporate minimum tax to ensure that "all profitable corporations pay a fair share of the corporate tax burden." In reference to this mandate, working group members identified several criteria to govern the design of such a tax.

First, members agreed that it would not be fair for corporations with real economic losses nor for profitable corporations already paying more than a specified minimum level of corporate income tax to be burdened with an additional corporate tax. Thus, the Group concluded that, if introduced, a corporate minimum tax should be imposed only on corporations with an evident ability to pay which nevertheless pay little or no corporate income tax.

Second, members concurred that a corporation's ability to pay should not be determined according to its income only in a single year. Instead, members were sympathetic to the fairness argument that corporations experiencing real economic losses in other years should be able to carry these losses over to reduce tax liabilities in profitable years.

Third, members agreed that a fair corporate minimum tax should avoid double taxation of corporate income by excluding dividends upon which a full measure of corporate income tax has already been paid.

Fourth, to ensure that a minimum tax on accelerated deductions affects only the timing of tax payments, without imposing an added tax burden, members agreed that where a minimum tax would otherwise impose an added tax burden in respect of these deductions it should be creditable against subsequent regular tax liability.

Fifth, members were generally agreed that in respect of these accelerated deductions the introduction of any corporate minimum tax should be accompanied by appropriate transitional measures, so that companies would not face retroactive taxation for investment decisions made under the existing tax regime.

Sixth, to ensure that foreign corporations are not adversely affected by a corporate minimum tax, members agreed that a minimum tax should be designed to ensure maximum creditability against taxes paid in the home countries of foreign corporations.

Seventh, given the existing allocation of taxing responsibilities between the federal and provincial governments, the design of an Ontario-based corporate minimum tax should consider not only what is jurisdictionally possible in Ontario, but also what is practical given provincial harmonization with federal tax rules regarding the taxation of corporate income and the partial integration of the corporate and personal income tax.

Eighth, to ensure that the tax would actually raise revenue, members were unanimous in the position that any corporate minimum tax that Ontario might introduce should be capable of effective administration. In other words, corporations should not be able to avoid the tax by employing accounting practices that restate financial profits or shift the taxable base to other jurisdictions.

Ninth, considering the potential costs of taxpayer compliance and administrative enforcement, members recognized simplicity as an important criterion for the design of a corporate minimum tax. On the other hand, it was generally acknowledged that simplicity is not always consistent with the goals of fairness and effective administration already outlined.

Finally, many members emphasized that the economic impact of a corporate minimum tax should be considered not only in deciding whether or not to introduce the tax but also in determining the form that it should take if introduced. Specifically, according to these members, a corporate minimum tax should do the following: minimize tax-induced distortions to the market, recognize the importance of additional capital investment and new businesses to economic growth and prosperity, and appreciate the constraints on corporate tax policy that are attributable to business mobility and the province's competitive position particularly vis-a-vis other provinces and the United States.

Design Options

Beyond specifying these criteria for the design of a corporate minimum tax, the working group felt constrained in its ability to provide the Treasurer with a specific recommendation on the design of a fair and effective corporate minimum tax.

Limitations of data and resources, combined with the need to report to the Treasurer prior to the 1992-3 budget, made it difficult for the Group to assess both the feasibility and the economic and revenue impacts of alternative types of corporate minimum tax. As a result, although the Group was able to consider several possible options for the design of a corporate minimum tax, it was largely unable to evaluate these options, except in a very general way.

The following sections present the options and design features considered by the Group, and the results of its discussions on these alternative designs.

(1) Dividend-Based Options

The data presented in Part II of this report indicate that non-taxation of inter-corporate dividends are one of the main reasons why reported profits are subject to little or no corporate income tax. As explained in the analytical overview of the corporate tax system, this deduction is consistent with the withholding function of the corporate income tax and is designed to prevent multiple taxation of corporate income distributed as dividends.

On the other hand, non-taxation of inter-corporate dividends is justified only on the assumption that the income out of which these dividends is paid has already been fully taxed at the level of the distributing corporation, an assumption that may not be true if dividends are received from an affiliate in a lower taxed jurisdiction or if the distributing company has been able to reduce or defer income taxes through the use of corporate tax preferences.

For this reason, many countries in which corporate and personal income taxes are fully or partially integrated also levy special refundable taxes on corporate distributions or limit the exempt portion on dividends received to an amount equal to the income tax actually paid on this income by the distributing company.[52] Although these dividend-based options are not minimum taxes per se, they prevent a potential inconsistency in the operation of an integrated corporate income tax system, and address one of the main reasons why profitable corporations may pay little or no income tax.

The working group was unable to obtain data on the extent to which inter-corporate dividends are actually paid out of income that has or has not been fully taxed. Nevertheless, members were generally agreed that non-taxation of dividends without regard to the amount of tax actually paid by the distributing company represents both a logical inconsistency in the operation of the current tax system and a potentially unacceptable reason why some profitable corporations pay little or no corporate income tax. As a result, several members suggested that the working group should consider whether some sort of dividends-based option would be feasible in Ontario.

Most members felt that the Group was unable to consider this question in sufficient detail to reach any firm conclusions as to how such a tax might be implemented solely in Ontario, if at all. In particular, aside from concerns about its economic impact, many members suggested that a dividends-based tax imposed at the provincial

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[52] Two clear examples of each of these alternatives are the Advance Corporation Tax (ACT) in the United Kingdom and the "franked" dividend system in Australia. See OECD Committee on Fiscal Affairs, *Taxing Profits in a Global Economy: Domestic and International Issues*, pp. 52-53. The federal government adopted a version of the former approach in 1987 when it introduced a refundable tax on dividends paid on preferred shares serving as debt substitutes. See Robert Dart, "A Critique of an Advance Corporation Tax System for Canada," pp. 1245-63. At the same time, a more general ACT was recommended by the House of Commons Standing Committee on Finance and Economic Affairs in its 1987 *Report on the White Paper on Tax Reform (Stage 1).*

level would be administratively complex,[53] easily avoidable,[54] and potentially unworkable. [55] Further, although some members favoured a dividend-based option above all others on the grounds that it is most consistent with the goal of tax preferences to encourage reinvestment (rather than distribution) of corporate profits, others viewed a dividend-based option as only a complement to (not a substitute for) a true corporate minimum tax since it would apply only to dividends, not to all profitable corporations paying little or no income tax.

In the end, although the Group did not dismiss the possibility that a dividend-based option could be introduced in Ontario, most members agreed that the question should be referred to the Fair Tax Commission to be considered as part of its overall review of the Ontario tax system.

(2) Income-Based Options

A second type of corporate minimum tax is based on one or another version of corporate income.[56] Most prominently, an ***alternative minimum income tax*** (AMT) would require corporations to pay the greater of their regular corporate income tax liability or an alternative amount determined by applying a lower tax rate against a broader income base.[57] Under a ***tax on tax preferences*** (TTP), a tax is levied on the total value of the tax preferences that a corporation employs.[58] Finally, a ***limit on tax preferences*** (LTP) establishes a ceiling on the extent to which corporations can use tax preferences in order to reduce their regular income tax.[59]

As with the dividend-based options, the working group felt constrained in its ability to develop and evaluate these options. Although several members viewed an alternative minimum income tax as most consistent with one of the objectives of a cor-

[53] In order to prevent double taxation of corporate income, companies would have to maintain records of tax paid on retained earnings and of tax paid on inter-corporate dividends. Moreover, where companies operate in more than one province, the provincial allocation formula would have to be used to determine the province from and to which dividends are paid.

[54] Under a system of "franked" dividends, for example, a company could avoid the tax by setting up a holding company to receive dividends outside the province.

[55] In particular, members emphasized the numerous problems associated with attempting to impose a provincial tax on dividends given both the federal system for the taxation of dividends and international treaties governing the taxation of foreign shareholders.

[56] For a detailed discussion of these options as applied at the personal level, see Canada: Department of Finance, *A Minimum Tax For Canada*.

[57] An alternative minimum income tax has existed in the United States since 1986. The U.S Alternative Minimum Tax has been subject to considerable analysis, some of which the group was able to consider. See Gerald Padwe, "The Death of GAAP Reporting? A Tale from the Folks Who Brought You U.S. Tax Reform;" Kendyl Monroe, "The Alternative Minimum Tax From a Practical Perspective;" Andrew Lyon, "Why a Minimum Tax;" and Lowell Dworin, "The Corporate Minimum Tax: The U.S. Experience."

[58] The U.S. levied a tax on tax preferences from 1969 until the U.S. federal government introduced an alternative minimum income tax in 1986.

[59] Although not a general limit on tax preferences, the federal government currently imposes a limit on the extent to which large corporations can use investment tax credits to offset federal income tax otherwise payable.

porate minimum tax to ensure that all profitable corporations pay at least a minimum amount of tax on their profits, most members considered it much more complex than either of the other two income-based options. On the other hand, although both a limit on tax preferences and a tax on tax preferences were regarded as more simple to design and to administer, several members questioned the logic of limiting or clawing back tax preferences that governments have deliberately introduced in order to advance specific economic and social policy goals.[60] In the end, the Group was unable to agree on which if any of these three income-based options would constitute an effective means of ensuring that profitable corporations pay a fair share of the corporate tax burden.

Despite these differences, members considered several aspects to the design of each option, and agreed on several features that any income-based corporate minimum tax should include. In a general way, they also discussed the advantages and disadvantages of these income-based options as methods of introducing a corporate minimum tax in Ontario.

Book Income versus Revised Income Base

A threshold issue in the design of each income-based option concerns the manner in which the alternative income base is defined. On the one hand, like the Indian Alternative Minimum Tax and like the U.S. Alternative Minimum Tax between 1986 and 1990,[61] the minimum tax could refer to annual profits that companies report to their shareholders.[62] On the other hand, a minimum tax could involve a revised definition of corporate income, based on information contained in each corporation's tax return.[63]

Although a book income base is favoured by some for its apparent simplicity and on the grounds that it directly addresses the perceptual issue of profitable corporations

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60 One argument that emerged in the course of discussions was that a province might introduce a tax on tax preferences in order to claw-back the provincial share of a federal tax preference with which it disagreed.

61 The Indian alternative minimum income tax is imposed at the same rate as the regular corporate income tax rate, but on 30 percent of the corporation's reported profits.. The U.S. AMT did not equate the alternative income base with book profits, but included a "book income adjustment" (half the difference between book income and taxable income) as an adjustment to regular taxable income.

62 For an alternative minimum income tax, book profits might serve as the alternative income base. For a tax on tax preferences, the base could be defined as the difference between book income and regular taxable income. In the case of a limit on tax preferences, this approach would suggest that companies could not reduce their taxable income below a fixed percentage of book income in any year (further adjustments would be necessary if tax credits and rate reductions were to be subject to the limit).

63 In the case of an alternative minimum income tax, this would involve adding back selected preference items to a company's regular taxable income. A tax on tax preferences would apply to the total value of these preference items themselves (as well as other preferences, if the value of tax credits and rate reductions is to be included in the base). For a limit on tax preferences, this approach would stipulate that companies could not reduce their taxable income below a fixed percentage of an adjusted income base, derived by adding back preference items to each company's taxable income (further adjustments would be necessary if tax credits and rate reductions were to be subject to the limit).

paying little or no corporate income tax,[64] the working group rejected the book income approach for two reasons.

First, since very few private companies obtain audited financial statements, and since generally accepted accounting principles (GAAP) are sufficiently flexible to allow income to be reported in various ways,[65] members doubted whether a book income base could be maintained without considerable difficulties in terms of compliance and administration. Although generally accepted accounting principles are employed in the federal Large Corporations Tax, members were more strongly influenced by the experience of the U.S. Alternative Minimum Tax, where the "book income adjustment" was abandoned after only a few years.

Second, having agreed that some reasons why profitable corporations pay little or no income tax are more acceptable than others, members rejected a book income approach as potentially unfair on the grounds that it might limit the ability of companies to carry forward real economic losses or impose a minimum tax on equity income and inter-corporate dividends in circumstances where corporate tax had already been paid.

Consequently, although the Group was unable to agree upon a list of preference items to be included in an alternative income base,[66] members agreed that if the Ontario Government were to introduce an income-based corporate minimum tax, it should at the very least be based on a revised definition of corporate income, including selected preferences already contained in each corporation's tax return.

Two key issues which the Group did not fully resolve concern the treatment of loss carryovers under a minimum income tax, and specification of the preference element in accelerated deductions for purposes of a such a minimum income tax. Since tax preferences may have contributed to prior years' losses, a minimum income tax might be expected to limit the extent to which they can be used to offset minimum tax liability.[67] Consequently, although many members emphasized that any such provision should avoid retroactive application to losses that have already occurred, several members thought that an income-based minimum tax should restrict the application of prior years' losses in some way. On the specification of the

64 See Graetz and Sunley.

65 See Glen Cronkwright, "The Dilemma of Conformity: Tax and Financial Reporting—A Perspective from the Private Sector."

66 The group considered the following as potential preference items to be included in the base: the accelerated element of capital cost allowances, the accelerated component of deductions for resource exploration and development, the amount by which the federal resource allowance exceeds resource taxes paid to the provincial government, rapid write-offs for for scientific research and development, investment tax credits for scientific research and development, the excluded portion of capital gains, rollovers on capital gains, deductions for business meals and entertainment, charitable deductions, rate reductions for manufacturing and processing and for small business, and loss carryovers to the extent that they are attributable to preference items.

67 In the United States, the AMT allows loss carryovers to offset no more than 90 percent of alternative minimum taxable income.

preference element in accelerated deductions, it was generally agreed that this should be calculated as the difference between book depreciation and depreciation for tax purposes.[68] However, since the differences between these measures reverse over the life of an asset, several members expressed concern that the value of preferences could be negative in some years.[69]

Besides discussing the base of the minimum tax, members also considered four details in the design of an income-based corporate minimum tax: its relationship to the regular corporate income tax, the issue of exemptions, the question of rates, and transitional arrangements to accompany the introduction of such a minimum tax.

Relationship Between Minimum Tax and Regular Corporate Income Tax

With respect to the relationship of an income-based corporate minimum tax to the regular corporate income tax, members considered two questions: first, whether the tax should be alternative to the regular corporate income tax or in addition to corporate income taxes otherwise payable; second, whether and to what extent the minimum tax should be creditable against regular corporate income taxes subsequently payable.

On the first question, it was generally agreed that an income-based minimum tax should apply only to the extent that it exceeds a corporation's regular income tax liability. Although a tax on tax preferences is often presented as an add-on tax levied in addition to the regular income tax,[70] most members rejected this approach on the grounds that it would require companies already paying an adequate amount of income tax to incur an additional charge on their use of tax preferences.[71]

On the second question, most members agreed that, at least to the extent that the minimum tax occurs because of preferences that defer regular income tax without resulting in a permanent reduction of tax, an income-based corporate minimum tax should be creditable against regular income taxes subsequently payable.[72] Otherwise, given the method of calculating the preference element in accelerated deductions, liability to minimum tax in one year could lead to over-taxation in a subsequent year if the corporation is again liable to regular income tax liability. Although some

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[68] In the case of capital cost allowances, the pooling of assets within a class would require either that these be broken out of the pool to determine their individual depreciation, or that an average percentage be established as the assumed difference for each class.

[69] It is for this reason that minimum taxes attributable to preferences that defer income tax without resulting in a permanent reduction of tax are often made creditable against regular income taxes subsequently payable.

[70] See Satya Poddar and David Leslie, "Issues in the Design of a Corporate Minimum Tax at the Provincial Level," pp. 21-23.

[71] Further, unless the add-on tax included special provisions for loss companies, this approach could require companies with real economic losses to pay a minimum tax on their use of tax preferences.

[72] In order to preserve the "minimum" character of the minimum tax, this credit should only be available to the extent that the regular income tax exceeds the minimum tax otherwise payable.

members argued that the tax should be creditable regardless of the reason it was imposed, the Group did not reach any consensus on this issue.

Exemptions

Most minimum income taxes contain a specific amount below which taxpayers will not be subject to minimum tax.[73] On the one hand, such a threshold is often defended on the grounds that it exempts smaller businesses from the costs of complying with the tax and allows all companies to make limited use of tax preferences without incurring minimum tax liability.[74] On the other hand, exemptions involve a loss of revenue and (without special rules for associated companies) encourage companies to split their income among a number of subsidiaries in order to maximize the number of thresholds available.

The working group did not discuss this issue in detail and reached no conclusions on whether or not a minimum income tax should contain an exemption or on how it should be defined if included.[75] Nevertheless, several members indicated that since special concessions are part of the problem that gives rise to a corporate minimum tax, exemptions should not be included in the design of an income-based corporate minimum tax.

Rates

The Group did not discuss the question of rates, except to agree that they were ultimately a subject to be decided by the Treasurer, in light of the revenue needs of the province. Nevertheless, the structure of a minimum tax suggests certain principles to govern the specification of a minimum tax rate.

First, since an alternative minimum income tax has a broader base than the regular income tax, the rate should be lower than the basic statutory rate of 15.5 percent in Ontario.[76] Second, if it is decided to preserve the value of some preferences, the AMT rate should be set so these are not automatically eliminated.[77] Third, since an add-on tax on tax preferences would be imposed in addition to (not instead of) the corporation's regular tax liability, one would expect the rate of tax in an add-on tax to

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[73] In the United States, the Alternative Minimum Tax contains an exemption of $40,000 of alternative minimum taxable income. An identical $40,000 threshold is contained in the Canadian personal alternative minimum tax.

[74] Holland and Castonguay, p. 37.

[75] Among other things, an exemption could be based on regular taxable income, alternative taxable income, or capital.

[76] In the United States, the federal alternative minimum tax is levied at a rate of 20 percent, compared to a 34 percent regular corporate income tax rate.

[77] For example, unless the tax is to operate as an automatic claw-back on the small business deduction (which reduces the tax rate from 15.5 percent to 10 percent), an alternative minimum tax should be levied at a rate of no more than 10 percent. Further, unless the tax is to operate as an immediate claw-back on the one quarter capital gains exclusion, an alternative minimum tax should not be levied at a rate exceeding 75 percent of the basic statutory rate or about 11.5 percent. Finally, unless the tax is to

be less than that for any alternative minimum tax, whether based on income or preferences.[78]

Transition

Members did not discuss issues of transition at any length. Nevertheless, most were agreed that the introduction of an income-based corporate minimum tax should be accompanied by appropriate transitional measures to ensure that companies would not face retroactive taxation for decisions made under the current tax regime.

Evaluation

For many members of the working group, the main appeal of these income-based options is the way in which they focus on one of the main causes of the phenomenon of profitable corporations paying little or no income tax: the use of tax preferences. Given the Treasurer's question and the design criteria developed by the Group, many members considered one or another of these income-based options to be the fairest kind of corporate minimum tax.

Notwithstanding this assessment, many members questioned whether an income-based corporate minimum tax could be effective, especially if introduced in one province alone. In addition to concerns about the potential economic impact of an income-based corporate minimum tax,[79] members noted the complexity of all income-based options especially an alternative minimum income tax,[80] questioned their feasibility particularly on a province-only basis,[81] and challenged the logic of imposing a claw-back on tax preferences delivered under the regular tax system in the form of a parallel minimum tax.

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function as an immediate claw-back on the excluded portion of any capital gain earned by a small business, an alternative minimum tax should not be levied at a rate more than 7.5 percent.

[78] In the United States, for example, the rate for the add-on minimum tax was 10% compared to 20% under the current alternative minimum tax.

[79] Members expressed concern that an income-based corporate minimum tax could blunt corporate tax incentives (particularly for research and development and for manufacturing companies), discourage investment and new businesses, and impede Ontario's tax competitiveness vis-a-vis Quebec and the United States.

[80] For each of the income-based options, the possibility of switching from the regular income tax to the minimum tax and vice versa creates considerable complexities regarding the timing of investment decisions. Complexities also arise in the treatment of prior years' losses, the determination of the accelerated element in accelerated deductions, and in provisions allowing minimum taxes to be credited against regular income taxes subsequently payable (which can be especially problematic where the company's allocation formula has changed during the interim).

[81] In addition to asking whether Ontario could legally or politically impose an income-based corporate minimum tax given federal responsibilities in this area, members questioned whether any income-based CMT would be enforceable given legal methods of avoidance such as leasing arrangements with affiliates in other jurisdictions, or reorganizations to allocate preference items to corporations with sufficient non-preference income to shelter the preference-related income.

(3) Capital-Based Options

A third form of corporate minimum tax might be based on some measure of a corporation's capital.[82] Assuming that this base is adequately defined, a capital-based CMT could be levied in addition to a company's regular income tax or as an alternative tax, payable only to the extent that it exceeds the company's regular income tax liability. Further, to the extent that the minimum tax is intended to target only ***profitable*** corporations paying little or no income tax, additional design features might provide special relief to companies with current or accumulated losses and/or to companies earning a low rate of return on capital.

As with each of the other design options, the working group was unable to fully develop and evaluate these capital-based options. Nevertheless, as with the income-based options just outlined, the Group considered several aspects to the design of a capital-based option, agreed on many of these features, and conducted a preliminary evaluation of a capital-based corporate minimum tax.

The Existing Capital Tax

Members devoted little attention to the task of defining a capital base for the simple reason that both Ontario and the federal government already impose taxes based on measures of corporate capital.[83] Consequently, if the provincial government were to introduce a capital-based corporate minimum tax, a workable definition of corporate capital would be readily available.[84]

For several members, however, this recognition led to the suggestion that Ontario already levies a corporate minimum tax in the form of the paid-up capital tax. Since this capital tax applies to profitable companies paying little or no income tax, these members argued that there was no need for ***another*** minimum tax to address the real or perceived problem of profitable non-taxpaying companies.

Although the Group did not address this issue in detail, it is difficult to characterize Ontario's paid-up capital tax as minimum tax on ***profitable corporations paying little or no income tax***. While the data in Part II indicate a rough correlation between the

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82 According to a recent study for the World Bank, most corporate minimum taxes are based on capital rather than income. Estache, p. 6.

83 Ontario's Paid-up Capital Tax levies a 0.3 percent annual tax on each company's "taxable paid-up capital" defined as: share capital + retained earnings and other surpluses + reserve funds + loans and advances—an allowance for investments in other corporations (shares of other corporations, loans and advances to other corporations, and bonds, debentures, mortgages and other securities issued by other corporations) in order to prevent double taxation. Loan and trust companies and banks are taxed only on equity and pay a rate of 1 percent. Insurance companies pay premium taxes of 2 or 3 percent, depending on their line of coverage. The federal Large Corporations Tax (LCT) levies a 0.2 percent annual charge on the capital of companies with more than $10 million in assets. While the Ontario tax measures assets according to tax rules, the LCT measures capital according to generally accepted accounting principles. For a description of the federal Large Corporations Tax, see David Williamson, "Large Corporations Tax."

84 A recent paper for the Canadian Tax Foundation suggests that this definition of capital might have to be reexamined for the purposes of a corporate minimum tax. Poddar and Leslie, p. 25.

extent of the capital tax burden and the industry sectors and company sizes where untaxed profits predominate, it is also evident that the capital tax falls mainly on profitable companies which already pay some corporate income tax and on companies paying little or no tax on account of current or prior years' losses.[85]

Consequently, although some members suggested that capital tax rates might be increased for industry sectors and/or company sizes where untaxed profits are most concentrated, most members rejected the existing capital tax as a plausible form of corporate minimum tax unless it were to be significantly reformed to exclude loss companies and profitable companies already paying an adequate amount of corporate income tax. As a result, although the Group considered the idea of a capital-based CMT integrated with the existing capital tax, throughout its deliberations it was generally assumed that a capital-based corporate minimum tax would take the form either of a surtax on Ontario's existing capital tax, or of a distinct levy perhaps along the lines of the federal Large Corporations Tax.

Relationship Between Minimum Tax and Regular Corporate Income Tax

As with the income-based options, the working group explored two questions concerning the relationship between a capital-based minimum tax and the regular corporate income tax: whether the tax should be an alternative or an add-on tax; and whether and to what extent the minimum tax should be creditable against regular corporate income taxes subsequently payable,

On the first issue, the group was unanimous that any capital-based minimum tax should apply only to the extent that it exceeds a corporation's regular tax liability. Further, since income taxes are creditable against U.S. corporate taxes whereas capital taxes not eligible for foreign tax credits, members agreed that regular income taxes should be creditable against the minimum capital tax liability as opposed to making capital taxes creditable against regular income tax liability.[86]

As to whether a capital-based minimum tax should be creditable against regular income taxes subsequently payable, the views of the group were less clear. Although it is arguable that the lack of any credit could result in over-taxation due to preferences that defer regular income tax without resulting in a permanent reduction of tax, the absence of a direct relationship between a minimum capital tax and the use of tax preferences undermines the strong argument for creditability that applies in the case of an income-based corporate minimum tax. There was no consensus on this issue.

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[85] Of $857 million in Ontario capital taxes paid in 1989, $158 million was paid by profitable corporations which paid no Ontario income tax, $400 million was paid by profitable companies which paid income tax, and $299 million was paid by companies which reported losses.

[86] This is now the case with the federal Large Corporations Tax (LCT), which was recently amended to allow the federal corporate income tax surcharge as a credit against LCT payable. Ontario's capital tax is deductible against corporate income. The federal government has proposed eliminating this deduction and replacing it with a 6 percent allowance, but has delayed further consideration of this proposal for a year.

Exemptions

The policy issues concerning exemptions to a capital-based minimum tax are much the same as those associated with an income-based minimum tax: on the one hand, exemptions reduce costs of compliance and administration; on the other hand, they entail a loss of revenue and create potential avenues for legal tax avoidance. In the case of a capital-based corporate minimum tax, an exemption could also be used to target corporations where untaxed profits appear to be most highly concentrated.[87]

Although the working group did not specifically address the subject of exemptions to a capital-based corporate minimum tax, both Ontario's capital tax and the federal Large Corporations Tax exempt companies with assets below specified threshold amounts. Consequently, to the extent that a capital-based minimum tax were designed as a surtax on Ontario's existing capital tax, it would necessarily adopt the same exemption as in the capital tax for companies with assets of less than $1 million. Similarly, a tax patterned on the federal Large Corporations Tax would exclude all companies with total assets of less than $10 million. On the other hand, Quebec's capital tax allows no exemption for small companies.

Special Relief

All members agreed that a capital-based CMT should apply only to ***profitable*** corporations paying little or no income tax. Nevertheless, members did not agree on the meaning of profitability, nor on the design features that should be contained in a capital-based minimum tax in order to relieve unprofitable corporations from the burden of any minimum tax liability.

At a basic level, all members agreed that companies with current or accumulated losses should not be subject to the minimum tax, provided that these losses represent real economic losses, not accounting losses generated through tax preferences.[88] Although the group was unable to evaluate a mechanism that might best achieve this policy objective, one suggestion was to allow companies with current or prior years' losses to redeem these losses for tax credits that could be applied against the minimum tax liability.[89]

In addition, some members argued that companies earning a low rate of return on capital should also qualify for special relief on the grounds that they too, like corporations with real economic losses, are unprofitable compared to other companies, and might otherwise be unfairly burdened by a capital-based minimum tax. Although the group was unable to evaluate alternative mechanisms for providing

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[87] For example, according to the data presented in Part II, about 86 percent of untaxed profits (after adjusting for equity income, inter-corporate dividends, loss carryforwards and the small business tax holiday, and after subtracting $1.3 billion of untaxed profits earned by insurance companies) were earned by corporations with taxable capital of more than $10 million.

[88] As for prior accounting losses, many members also emphasized that any restriction on loss relief should avoid retroactive application to losses that have already occurred.

this relief, one member suggested an approach that would vary the surtax percentage according to the corporation's rate of return on capital, so that a higher rate of return would attracts a higher surtax while a corporation with a lower rate of return on capital would face a lower surtax.[90] Alternatively, it has also been suggested that the minimum tax could be made subject to a ceiling determined according to a specified percentage of book income.[91] However, unlike relief for loss companies, the group did not reach a consensus on this issue.

Rates

As with the income-based options that it considered, the working group did not discuss the question of rates, except to agree that they were ultimately a subject to be decided by the Treasurer in light of the revenue needs of the province.

Evaluation

For most members of the working group, the main appeal of a capital-based option is its simplicity compared to the income based options,[92] and (given the existing capital tax), its obvious feasibility at the provincial level. On the other hand, in addition to concerns about its economic impact, many members questioned whether it could be made sufficiently sensitive to profitability (however defined) to be fair.

Conclusions

Despite a broad range of agreement on the criteria that should govern the design of a corporate minimum tax, and on specific features in the design of a corporate minimum tax, the working group was unable to agree on the design of an "effective" corporate minimum tax to ensure that "all profitable corporations pay a fair share of the corporate tax burden."

In part, this reflects data and resource limitations which, combined with the need to report to the Treasurer prior to the 1992-3 budget, made it difficult for the group to assess both the feasibility and the economic and revenue impacts of alternative types of corporate minimum tax.

In addition, though, this conclusion reflects the difficult trade-offs involved in an attempt to design both a fair and effective corporate minimum tax. While many members viewed a dividend-based option as fair, few thought that it could be effective in Ontario. Similarly, while many members considered one or another income-

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[89] Although a scheme of loss refundability along these lines apparently exists in Quebec, the group was unable to examine this system.

[90] According to this suggestion, the rate of return used for adjusting the surtax could be determined by dividing the corporation's after-tax profit on its financial statements by the value of its paid-up capital (without subtracting the investment allowance). To the extent that accelerated deductions reduce a company's taxable capital, this approach would also make the surtax somewhat sensitive to use of preferences.

[91] Poddar and Leslie, p. 25.

[92] On the other hand, to the extent that a capital tax provides special relief to unprofitable companies, this advantage of simplicity is reduced.

based option to be fair, many also questioned whether they could be effective. On the other hand, while most members regarded a capital-based option as workable, there was significant concern about whether it could be made sufficiently profit-sensitive to be fair.

IV. Conclusions and Recommendations

(A) Conclusions

The Treasurer asked the group to address a primary question and the Fair Tax Commission added three supplementary questions. In addition, the group decided that it should consider whether or not Ontario should introduce a corporate minimum tax.

1. The Treasurer's Question

> *What type of corporate minimum tax (CMT) would be most effective at improving the fairness of the tax system by ensuring that all profitable corporations pay a fair share of the corporate tax burden?*

1.1. The working group was divided on the need, desirability and objectives of a corporate minimum tax in Ontario, and felt constrained in its ability to develop and evaluate design options. However, in response to the Treasurer's question, members proceeded to examine options for the design of a corporate minimum tax and agreed upon criteria and specific features to inform the design of a corporate minimum tax in Ontario. In its discussion of the design issues arising from its consideration of various forms of a corporate minimum tax, the group did reach various conclusions.

Main Design Options:

Corporate Minimum Tax Based on Dividends

1.2. Although members agreed that non-taxation of dividends without regard to the amount of tax actually paid by the distributing company represents both a logical inconsistency in the operation of the current tax system and a potentially unacceptable reason why some profitable corporations pay little or no corporate income tax, the working group thought that it would be difficult to implement a dividend-based tax in Ontario alone.

Corporate Minimum Tax Based on Book Income

1.3. The fact that many companies report book profits but pay no income tax raises questions about the fairness of the tax system and indeed precipitated the Treasurer's question. On the surface, it would appear that a minimum tax levied on book profits would address this apparent unfairness and be simple to administer.

1.4. However, on the question of fairness such a tax would not take account of the reasons these profitable companies pay no tax. For example, apart from tax preferences the two major reasons why these profitable corporations pay little or no income taxes are loss carryforwards and inter-corporate dividends.

1.5. Losses in a prior year may be used to reduce or eliminate the current years tax. The working group agrees that recognition of prior year's losses should be part of any corporate minimum tax.

1.6. A major component of corporate book profits is dividends from other corporations. To the extent that these dividends may already have been subject to tax, they should not be part of a corporate minimum tax base.

1.7. Although a tax on book profits may appear simple and easy to enforce the fact is a majority of Ontario corporate taxpayers do not prepare audited financial statements. Furthermore, generally accepted accounting principles allow for a range of choice of accounting methods. For these reasons book profits do not provide a consistent tax base across the corporate sector. This together with the potential for manipulation of book profits would inevitably result in further complexities aimed at ensuring enforcement.

1.8. Therefore, the working group rejected a book income approach to designing a corporate minimum tax because the tax base would be inequitable and in practice, it would be complex and difficult to enforce.

Corporate Minimum Tax Based on Adjusted Book Income

1.9. In its consideration of income based options, the group addressed the issue of deductions from book income that were generally considered too important or significant to be neglected as would be the case if a minimum tax were imposed on unadjusted book income.

1.10. In its examination of adjusted book income systems in operation elsewhere, in particular the U.S., there was no readily available model that appealed to the group.

1.11. Two categories of deductions from book income for tax purposes can be identified: permanent differences and timing differences. The principle permanent differences arise from the tax treatment of inter-corporate dividends and of loss carry-forwards.

1.12. An alternative minimum tax assessed on book income adjusted for inter-corporate dividends and losses may be an option worthy of further study. To the extent that taxes imposed under such a system are attributable to timing differences, they should be made creditable against corporate income tax payable in future years.

1.13. This type of system would ensure that most profitable corporations reporting book profits would pay some income tax but would not increase the tax burden on start-up or loss companies or profitable companies already paying significant tax.

1.14. The main drawbacks of this system are the same as those associated with a corporate minimum tax on unadjusted book income: because most Ontario corporations do not prepare audited financial statements and because generally accepted accounting principles allow for a range of choice of accounting methods, even adjusted book profits do not provide a consistent tax base across the corporate sector.

Further, the potential manipulation of book profit for tax avoidance purposes would inevitably result in further complexities aimed at ensuring enforcement.

Corporate Minimum Tax Directed at Tax Preferences

1.15. The Working Group considered three options: (a) an alternative minimum tax on adjusted taxable income; (b) a tax on tax preferences levied on the total value of tax preferences deducted by a corporation; and (c) a cap on tax preferences, limiting the extent to which a corporation may use tax preferences in order to reduce its regular income tax to zero or close to zero.

1.16. The main advantages of these approaches are their visibility and relative certainty in terms of their impact. For some members, they also convey a message that in introducing tax preferences, tax policy makers did not necessarily intend that these could be combined in such a way that corporations could reduce their income tax payable to zero. Thus, these approaches are seen by some as protecting the integrity of the revenue raising function of the tax system, while preserving the individual preferences which represent policy initiatives.

1.17. These approaches might also be appealing to those favouring a corporate minimum tax in that they allow targeting of particular preferences which may be considered less justifiable than others.

1.18. Unresolved problems include: the definition of tax preferences and agreement on which preferences to include in the minimum tax base; difficulties in designing a minimum tax that does not penalize taxpayers who have taken advantage of previous policy incentives; lack of agreement about the logic of limiting or clawing back preferences that the federal or provincial governments have introduced to achieve social or economic policy objectives; complexities associated with the treatment of preferences that defer but do not permanently reduce corporate income taxes; questions about how to design these options to apply to complex financial structures (e.g. partnerships); and possibilities of avoidance through arrangements with associated companies.

Corporate Minimum Tax Based on Capital

1.19. Compared to an option based on income, most members viewed a capital-based corporate minimum tax as more workable in Ontario, with significant advantages in terms of simplicity and ease of compliance. Corporate taxpayers already pay a capital tax which is easily calculated and has resulted in less significant compliance problems than an income-based tax.

1.20. A capital-based corporate minimum tax could take the form of a distinct capital tax like the federal Large Corporations Tax or a surtax on the existing capital tax, or could be integrated with the existing capital tax.

1.21. The group recognized that a capital based corporate minimum tax would mean that some profitable companies could still earn positive book profits but pay little or

no corporate ***income*** tax. The group agreed that this would result in at most a problem of unfounded public perception of unfairness.

1.22. The existing capital tax serves some of the functions of a corporate minimum tax in the sense that it is levied on all corporations above a minimum threshold and therefore applies to many corporations with positive book profits paying little or no corporate income tax. While preferable in terms of simplicity and compliance, an increase in the existing capital tax would not address the specific problem of profitable corporations that do not pay income tax. This is because it would be an additional tax on profitable corporations which are already paying corporate income tax, would apply to unprofitable companies, and would fall disproportionately upon companies which, while profitable, are earning only a low rate of return on capital.

1.23. A capital-based corporate minimum tax would be fair only to the extent that it would be sensitive to regular corporate income taxes paid and profits earned by corporate taxpayers. This could be done by making corporate income taxes creditable against the minimum capital tax payable (which would also allow foreign-owned companies to preserve foreign tax credits), and by providing special relief for loss-making and marginally profitable companies. If a corporate minimum tax took the form of making the existing capital tax profit-sensitive, the rate would have to be adjusted relative to revenue needs.

1.24. A concern was the extent to which a capital-based minimum tax could be made sensitive to corporate profitability without reintroducing the disadvantages of complexity and avoidance associated with the income-based options.

Conclusion

1.25. To the extent that a corporate minimum tax is intended to target only profitable companies unfairly paying little or no income tax, the Group agreed that it was drawn to some sort of adjusted income approach. However, members generally agreed that a capital-based option seems more advantageous in terms of simplicity, practicality, and the ability of such a tax to raise revenue.

Design Criteria and Features:

Design Criteria

1.26. Members agreed that it would not be fair for corporations with real economic losses nor for profitable corporations already paying above a specified minimum level of corporate income tax to be burdened with an additional corporate tax. Thus, the group concluded that a corporate minimum tax should be considered only on corporations with an evident ability to pay which nevertheless pay little or no corporate income tax.

1.27. Members concurred that a corporation's ability to pay should not be determined according to its income only in a single year. Instead, members were sympathetic to the fairness argument that corporations experiencing real economic losses in other

years should be able to carry these losses over to reduce tax liabilities in profitable years.

1.28. Members agreed that a fair corporate minimum tax should avoid double taxation of corporate income by excluding dividends upon which a full measure of corporate income tax has already been paid.

1.29. To ensure that a minimum tax on accelerated deductions affects only the timing of tax payments, without imposing an added tax burden, members agreed that where such a minimum tax would otherwise impose an added tax burden it should be creditable against subsequent regular tax liability.

1.30. Members were generally agreed that in respect of these accelerated deductions the introduction of any corporate minimum tax should be accompanied by appropriate transitional measures, so that companies would not face retroactive taxation for investment decisions made under the existing tax regime.

1.31. To ensure that foreign corporations are not adversely affected by a corporate minimum tax, members agreed that a minimum tax should be designed to ensure maximum creditability against taxes paid in the home countries of foreign corporations.

1.32. Given the existing allocation of taxing responsibilities between the federal and provincial governments, the design of an Ontario-based corporate minimum tax should consider not only what is jurisdictionally possible in Ontario, but also what is practical given provincial harmonization with federal tax rules regarding the taxation of corporate income and the integration of the corporate and personal income tax.

1.33. To ensure that the tax would actually raise revenue, members were unanimous in the position that any corporate minimum tax that Ontario might introduce should be capable of effective administration. In other words, corporations should not be able to avoid the tax by accounting practices that restate financial profits or shift the taxable base to other jurisdictions.

1.34. Considering the potential costs of taxpayer compliance and administrative enforcement, members recognized simplicity as an important criterion for the design of a corporate minimum tax. On the other hand, it was generally acknowledged that simplicity is not always consistent with the goals of fairness and effective administration already outlined.

1.35. Many members emphasized that the economic impact of a corporate minimum tax should be considered not only in deciding whether or not to introduce the tax but also in determining the form that it should take if introduced. Specifically, according to these members, a corporate minimum tax should do the following: minimize tax-induced distortions to the market, recognize the importance of additional capital investment and new businesses to economic growth and prosperity, and appreciate the constraints on corporate tax policy that are attributable to business

mobility and the province's competitive position particularly vis-a-vis other provinces and the United States.

1.36. Generally, there was a concern about the balance between the need for tax revenues from the corporate sector on the one hand, and the importance of the Province maintaining a competitive tax structure on the other.

Design Features

1.37. Regardless of whether a corporate minimum tax were to be based on income or capital, members agreed that it should apply only to the extent that it exceeds a corporation's regular income tax liability. In other words, should the Government introduce a CMT, the working group recommends that this tax should be an alternative tax, not an add-on tax that would apply in addition to a corporation's regular income tax liability.

1.38. In the case of a capital-based CMT, members agreed that since income taxes are creditable against U.S. corporate taxes (whereas capital taxes are not eligible for foreign tax credits) regular income taxes should be creditable against the minimum capital tax liability (as is now the case with the federal Large Corporations Tax) as opposed to making capital taxes creditable against regular income tax liability.

1.39. In the case of a capital-based CMT, members agreed that companies with current or accumulated losses should not be subject to the minimum tax, provided that these losses represent real economic losses, not tax losses generated through tax preferences. Although the group is unable to recommend a mechanism to achieve this policy objective, one suggestion is to allow companies with current or prior years' losses to redeem these losses for tax credits that could be applied against the minimum tax liability.

1.40. In the case of an income-based CMT, members agreed that minimum taxes that are incurred because of preferences that defer income taxes should be creditable against regular income taxes payable in subsequent taxation years. In the case of a capital-based CMT, the Group did not discuss this issue of creditability at any length.

2. The Fair Tax Commission's Questions

(1) What are the objectives for a corporate minimum tax?

2.1. The working group was divided both on the need for and the objectives of a corporate minimum tax.

2.2. Among those favouring a corporate minimum tax, the main objectives of the tax were to ensure that all corporations earning profits in Ontario pay at least a minimum amount of income tax, to preserve the progressivity of the tax system by ensuring that the ultimate recipients of corporate income cannot avoid or defer tax on this income, and to obtain additional tax revenue from the corporate sector in a relatively fair way.

2.3. Other members questioned both the validity of these objectives and whether they could or should be pursued through a corporate minimum tax. In particular, some members opposed the idea that a corporate minimum tax should be used to raise additional revenues.

(2) Given the objectives, what should the design be?

2.4. Members agreed that some reasons why companies reporting annual profits may pay little or no income tax are more acceptable than others, and that the case for a corporate minimum tax was strongest when targeted at tax preferences serving the economic and social policy function of the corporate income tax, rather than other features of the corporate income tax system that account for differences between annual book profits and taxable income.

2.5. Members felt that a corporate minimum tax ought to be simple, efficient and fair. To some extent, these objectives conflict. Most members favouring a corporate minimum tax thought that the tax ought to target preference items. This suggests an income-based tax rather than a capital tax. To some extent, an income-based tax is more complicated than a capital tax, although the extent to which this is so depends on the particular models being compared. Nonetheless there was a view that an income tax was preferable to the extent that it directly addresses the perceived problem of fairness. However, members agreed that a capital-based option seems most advantageous in terms of simplicity, practicality, and the ability of such a tax to raise revenue on a fairly predictable basis.

2.6. Many members said that any corporate minimum tax should be neutral in its application across industry sectors. However, others felt strongly that the government should be free to pursue an industrial strategy that included encouraging different industries in different ways. It was generally felt that the working group had neither the time nor the resources to address this aspect of the various design options we considered.

2.7. Members agreed that the tax ought to be reasonably workable, having regard for the fact that corporations may reorganize their way of doing business if the tax burden in Ontario is perceived to be unduly onerous. Members did not feel that their analysis of possible design options had proceeded to the point that they were prepared to make a recommendation in favour of any particular approach, beyond noting the practical importance of this consideration.

2.8. Many members favouring a corporate minimum tax thought that Ontario ought not to proceed with a tax that raises little revenue. They thought the negative aspects of such a tax would likely outweigh the theoretical benefits, in terms of fairness, of doing so. However, a few members thought we ought to have a corporate minimum tax as part of an overall tax system that would more fairly tax corporations, regardless of the immediate revenue consequences and would act as a safety net for future tax expenditures. Alternatively, if Ontario does not introduce a corpo-

rate minimum tax some members thought that this issue should be investigated again at a later date based on revenue projections at that time.

(3) Can those objectives be met through policy instruments other than a corporate minimum tax?

2.9 The group did not spend a lot of time considering whether the objectives of a corporate minimum tax could be achieved in some other way. In part, this reflects the fact that the working group did not agree on the objectives of the tax and on whether a corporate minimum tax is desirable. However, four observations can be made.

2.10. To the extent that there is concern about the operation of the rules in the present system that allow deductions for tax purposes at a rate that is different from that allowed under generally accepted accounting principles (GAAP), it was recognized that one approach was to amend the existing rules to deal with this concern. In other words, if a problem exists, deal with it in the context of the existing system by eliminating deductions and credits that allow companies to pay little or no income tax. This has the merit of focusing on the rationale for the policy decisions that allow deductions for tax purposes at a rate that differs from that allowed under GAAP.

2.11. Also, members considered the merits of placing caps on each preference item as an alternative approach, such as now exists with respect to the creditability of investment tax credits for scientific research and development. On the other hand, it was suggested that the nature of the political process was such that there would often be cases in which it would be difficult to deal with individual preference items because of interest group pressure and that an appropriate response to this was a system that imposed a separate minimum tax outside the basic regime. There was no consensus in the working group on this point.

2.12. A third alternative would be to adopt a targeted approach consisting of specific reforms aimed at corporations or industry sectors where untaxed profits are most concentrated. To some extent, this was the route taken by the federal government, which levies capital taxes on insurance and finance companies and a Large Corporations Tax on companies with assets of more than $10 million. Although a capital tax is open to the criticism that it does not specifically address the problem of profitable corporations not paying an appropriate amount of income tax, to the extent that available data suggests that a significant proportion of the profits earned by corporations in Ontario that are now bearing little or no income tax are being earned by a relatively few large corporations, there may be a case to be made for a new tax that is similar to the Large Corporations Tax introduced by the federal government in 1989. The Group did not discuss this at length, but was concerned that an approach along these lines should not impose onerous levels of new taxation on unprofitable corporations or companies already paying a full measure of corporate income tax.

2.13. Finally, some members suggested that, to the extent that a corporate minimum tax is designed to raise revenues, this could be accomplished more directly by a straightforward increase in the corporate income or capital tax rates.

(4) What is the relationship between a corporate minimum tax and other corporate taxes paid?

2.14. The working group did not examine this question in detail, except with respect to whether the existing capital tax could be considered a corporate minimum tax. Although several members insisted that the many fixed taxes that corporations now pay (capital, payroll, property and business, sales and excise) constitute "minimum" taxes, it was generally agreed that these taxes were not minimum taxes on corporate *income* and that it was this latter type of tax with which the group was concerned.

2.15. With respect to the relationship between a corporate minimum tax and regular corporate income taxes payable, members agreed on two points.

2.16. Members agreed that a CMT should be an alternative tax, payable only to the extent that it exceeds a corporation's regular income tax liability. In this respect, some members suggested, a CMT should be viewed as part of the regular corporate income tax, not as a separate and additional tax.

2.17. In the case of an income-based CMT, members agreed that minimum taxes that are incurred because of preferences that defer income taxes should be creditable against regular income taxes payable in subsequent taxation years. In the case of a capital-based CMT, the Group did not discuss this issue of creditability at any length.

3. The Working Group's Question

Should the Ontario Government introduce a corporate minimum tax at this time?

3.1. The working group was unable to agree on whether or not the Government should introduce a corporate minimum tax at this time. In part this reflects limitations in the data available to evaluate the need for a CMT. In part, it reflects limitations in the working group's ability to evaluate both the feasibility and the revenue and economic impacts of alternative CMT options. In part it reflects different underlying philosophies regarding the nature and purpose of the corporate income tax and the tax system generally.

3.2. Nevertheless, members were generally agreed that, as part of any decision on whether and how to proceed with a corporate minimum tax, it would be desirable if the government were to conduct a more thorough evaluation of both the feasibility and the revenue and economic impacts of alternative CMT options than the working group was able to do.

(B) Recommendations

In the course of its work, a number of recommendations occurred to the working group. Most of these relate to further analysis that it seems to us ought to be done before a decision is made with respect to the question whether some form of corporate minimum tax would result in a fairer sharing of the corporate tax burden in Ontario. We were concerned about the lack of current data that would assist in analyzing the scope of the perceived problem and the impact of any decisions taken to respond thereto. While we were not asked specifically to comment in this regard, many members of the working group thought it desirable for us to express our views about these broader matters.

4.1. Several members emphasized that the government should quickly decide whether or not to introduce a corporate minimum tax, in order to alleviate the uncertainty currently affecting the corporate community in this regard.

4.2. Nevertheless, several members thought that there were a number of matters that required additional study as part of the decision about whether or not and how Ontario ought to proceed with some form of corporate minimum tax. For these members, the following issues were identified as relevant to any decision to proceed with a corporate minimum tax.

4.3. Who pays the corporate tax and who would pay a corporate minimum tax? If additional taxes are imposed on the corporate sector, do we know the real incidence of those taxes? On a sectoral basis, do we understand how a corporate minimum tax might affect the availability of jobs, profits etc. in those sectors? We believe it is vital that a proposal for any particular form of corporate minimum tax be analyzed in this context as part of the decision making process.

4.4. To the extent that a significant part of the concern about a corporate minimum tax involves the question of whether a corporation ought to be able to reduce taxable income by deducting tax preferences, what do we know about the economic benefits of such preferences? If a minimum tax based on preferences would have the effect of reducing the impact of such preferences, is this a good result? Are some preferences better than others in this regard? Should there be an overall review of the existing preference items before a decision is taken to proceed with a corporate minimum tax on such items? We think a thorough review of these questions is required as part of any decision to introduce a corporate minimum tax.

4.5. The treatment of inter-corporate dividends should be considered in the context of the present rule granting an individual a dividend tax credit whether or not a full measure of corporate tax has been paid at the underlying corporate level. The issue here goes beyond the technical question of the pros and cons of integrating corporate and shareholder income. In the Canadian context, there is the question of whether it

is appropriate tax policy to treat dividends in any particular way and, more important, how and where decisions with respect to the treatment of such items ought to be taken. An important question for Ontario is the extent to which, if at all, such decisions ought to be taken by the Province on an independent basis. In the case of the treatment of dividends and the dividend tax credit, we think that it would be difficult for Ontario to go it alone on this issue. However, several members think that the Fair Tax Commission might well give thought to this as part of their review of the overall system.

4.6. We were unable to consider the likely impact of introducing any particular form of corporate minimum tax on the various industry and service sectors in Ontario. Some members emphasized that a corporate minimum tax should be designed to support a broader industrial strategy for Ontario. We think further analysis needs to be done in this area before any decision is made to adopt a corporate minimum tax in Ontario.

4.7. Members were generally concerned about the impact of a corporate minimum tax on the competitive position of corporations doing business in the Province. Again, this was a matter on which we felt that we did not have sufficient data to make a specific recommendation. But we did feel that this was a matter that required additional study as part of any decision to introduce a corporate minimum tax.

4.8. An important consideration is the question of whether any particular form of tax is, in fact, workable. As we have noted, we did not have the time or resources available to analyze the possible implications of various types of corporate minimum tax. We think it is important that this sort of analysis be done as part of any decision to proceed with this form of tax.

4.9. More thought needs to be given to the operation of the consultative process for tax reform. In the limited time available to us, we found that there seemed to be no effective way for low income groups to make their views known to us. In part, this is a question of resources. In a more general way, it perhaps reflects a question about how tax policy ought to be formulated in Ontario in the 1990's. We think that thought needs to be given to this question in the overall work of the Fair Tax Commission.

4.10. Members suggested that the Fair Tax Commission, as part of its larger review of the overall system, investigate the role and rationale of the Ontario Capital Tax with a view to allowing a degree of refundability of economic losses as part of the larger review of the overall system.

4.11. Several members of the Group recommend that the Fair Tax Commission, as part of its overall review of the Ontario tax system, also consider whether the present system for exempting inter-corporate dividends from tax is appropriate in all cases and, if it is not, the extent to which this is a matter which Ontario ought to address in conjunction with the federal authorities or on its own.

4.12. If Ontario is to engage in the kind of policy-making exercise in which the corporate minimum tax working group participated, most members observed that Ontario needs a more developed database focused on the profits earned and the taxes paid by corporations doing business in the Province. As we understand it, at the present time, most of the information available to policy makers in the Province are derived from information gathered by the federal government for its own purposes. These purposes do not necessarily assist Ontario policy makers in assessing the likely impact of changes in taxation directed to circumstances particular to Ontario. While we accept in general terms the desirability of maintaining harmony between the tax policies of the Province and the other jurisdictions in Canada, it nonetheless seems to us that it would be desirable for Ontario to develop and maintain a database that is directed specifically at the position of corporations doing business in Ontario, taking account of the most recent data available. There are cost and other ramifications here that we do not feel qualified to comment on. Nonetheless, it struck us as anomalous that we did not have available to us basic data regarding the amount of corporate profits currently being earned in Ontario and bearing little or no tax, nor a sophisticated modelling system which would enable us to anticipate the likely effects of implementing a corporate minimum tax of one kind or another. We were not in a position to determine whether it was cost efficient for Ontario to attempt to establish such a system on its own. It did seem to us, however, that in the absence of such a system, the formulation of tax policy in Ontario was going to be more haphazard than otherwise would be desirable having regard to the consequences of making decisions on the basis of faulty or incomplete information.

V. Appendix

(A) Organizations that Prepared Written Submissions:

APC Ltd.
Board of Trade of Metropolitan Toronto
Canadian Bankers Association
Canadian Bar Association - Ontario
Canadian Chemical Producers' Association
Canadian Federation of Independent Business
Canadian Institute of Public Real Estate Companies
Canadian Life and Health Insurance Association Inc.
Canadian Manufacturer's Association
Child Poverty Action Group and The Social Planning Council of Metropolitan Toronto
Conference Board of Canada
Council of Ontario Construction Associations
Deep Foundations Contractors Inc.
George Weston Limited
IBM Canada Ltd.
Insurance Bureau of Canada
Lumber and Building Materials Association of Ontario
Mississauga Board of Trade
Motor Vehicle Manufacturers' Association
Moore Corporations Limited
Ontario Chamber of Commerce
Ontario Forest Industries Association
Ontario Mining Association
Ontario Natural Gas Association
Ontario Restaurant Association
Pharmaceutical Manufacturers Association of Canada
Price Waterhouse
Prospectors and Developers Association of Canada
Stelco Inc.
Sun Life Assurance Company of Canada
Task Force on Food Banks
Tax Executives Institute
Trust Companies Association of Canada
United Co-operatives of Ontario

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* These materials were considered but not distributed to members of the Working Group.

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